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EGTRRA and the Past, Present, and Future of Oregon's Inheritance Tax System

On June 7, 2001, President George W. Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).[1] The Act changed numerous portions of the tax code in the process of lowering federal taxes by $1.35 trillion.[2] One of the highly trumpeted changes to the tax code brought about by EGTRRA was the repeal of the federal estate tax in 2010.[3] This repeal is currently scheduled to only last one year, but many of EGTRRA's provisions may become permanent.[4] The changes implemented by EGTRRA have had a major effect on state tax systems.[5] Although the estate tax is scheduled for repeal, the changes wrought by EGTRRA may actually make state and federal tax planning more difficult for wealthy families, and the uncertainty surrounding the temporary nature of the changes only compounds this difficulty.[6]

Oregon, like many states, has been affected by EGTRRA and has implemented several changes to its inheritance tax system. Because of the changes at both the state and federal levels, many of Oregon's taxpayers and estate-planning practitioners have

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1 *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (codified in scattered sections of 26 U.S.C.).

2 Sergio Pareja, *Estate Tax Repeal Under EGTRRA: A Proposal for Simplification*, 38 REAL PROP. PROB. & TR. J. 73, 74 (2003).

3 *Id.*; *see* Economic Growth and Tax Relief Reconciliation Act of 2001 § 501(a) (amending 26 U.S.C. § 2210).

4 Pareja, *supra* note 2, at 74, 77-78.

5 Throughout this Comment, the term "states" also includes the District of Columbia.

6 Pareja, *supra* note 2, at 74-75.

been placed in a precarious situation. Numerous existing estate plans have been disrupted, and due to the uncertainty surrounding many of the EGTRRA-related changes, taxpayers and estate planners have been unable to determine what actions to take in response.

Parts I and II of this Comment will provide an overview of the federal estate tax system and discuss EGTRRA's recent changes to it. Part III will discuss EGTRRA's effect on states and the general approaches that states have taken in response. Part IV will provide a historical overview of Oregon's inheritance tax system. Part V will examine EGTRRA's effects on Oregon's inheritance tax system and Oregon's initial response of decoupling from the federal system. Part VI will examine what these changes mean to taxpayers and estate-planning practitioners in Oregon. Lastly, Part VII of this Comment will discuss the potential effects of several inheritance tax bills that were considered by Oregon's legislature during the recent 2005 legislative session.

I

A Historical Overview of the Federal Estate Tax System

In 1797, the federal government first began taxing property passing from a decedent when it enacted a temporary inheritance tax.[7] Over the next century, temporary death taxes[8] were imposed several times, often as a means of financing wartime revenue needs, until the current estate tax was enacted in 1916.[9] The 1916 tax was not repealed after World War I due to a growing

[7] Jesse Dukeminier & Stanley M. Johanson, Wills, Trusts, and Estates 977 (6th ed. 2000); Louis Eisenstein, *The Rise and Decline of the Estate Tax*, 11 Tax L. Rev. 223, 225 (1956); Dean L. Surkin, *The Impact of the Decoupling of State Estate Taxes on a Taxpayer's Choice of Domicile*, 101 J. Tax'n 49, 49 (2004). Although this first tax was an inheritance tax, the current federal tax is an estate tax. An estate tax is levied on the gross estate of the decedent for the privilege of transferring property. Dukeminier & Johanson, *supra* at 980. In contrast, an inheritance tax is levied on beneficiaries for the privilege of receiving property from the decedent. *Id.*

[8] This Comment will attempt to appropriately label estate and inheritance taxes according to the specific nature of the tax, but it will refer to them generally using the term "death taxes." This term has an unfortunate pejorative connotation not intended by the author. The term "death tax" has been used as far back as 1937 to refer to both estate and inheritance taxes. Surkin, *supra* note 7, at 50 & n.11.

[9] Dukeminier & Johanson, *supra* note 7, at 977; *see* Surkin, *supra* note 7, at 49-50. For an excellent, in-depth historical summary of federal death taxes, see Eisenstein, *supra* note 7, at 223-38.

public perception that death taxes could be used to raise revenue and to level the accumulated fortunes of American industrialists.[10]

In addition to the federal estate tax, Congress has created two other wealth transfer taxes. In 1924, the federal gift tax was imposed as a means of preventing persons from avoiding the estate tax through the use of inter vivos gifts.[11] In 1986, the Generation-Skipping Transfer Tax (GST) became the third major wealth transfer tax enacted by Congress.[12] Congress' purpose in enacting the GST was to ensure that a wealth transfer tax was paid once per generation.[13] Not surprisingly, Congress has modified these wealth transfer taxes many times over the years. One important change was the unification of the federal estate and gift taxes in 1976.[14] This unification was accomplished by creating a single schedule of tax rates that was applied on the basis of cumulative transfers of property made both during the lifetime of the transferor and upon the transferor's death and also through a single combined lifetime exemption for all such transfers.[15]

At the same time that the federal gift tax was originally enacted, a state death tax credit[16] was created as a means of quelling state opposition to a permanent federal estate tax.[17] Death taxes were traditionally viewed as an area of state taxing power, and the addition of a federal tax to the existing layer of state taxes was politically cumbersome for states.[18] The state death tax credit created a revenue-sharing arrangement between the federal government and the states whereby Congress granted the taxpayer a reduction in the federal estate tax owed (up to speci-

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[10] DUKEMINIER & JOHANSON, *supra* note 7, at 977-78. Dukeminier and Johanson's discussion of the perception of death taxes early in this century as a means of leveling the great fortunes and "striking at 'the evils of inherited economic power'" stands in stark contrast to the current political rhetoric of creating an "ownership society." *See id.* at 978 (quoting President Hoover). For further discussion on the topic of death taxes as a social policy of wealth redistribution, see also Eisenstein, *supra* note 7.

[11] DUKEMINIER & JOHANSON, *supra* note 7, at 978; Eisenstein, *supra* note 7, at 232. Inter vivos gifts are gifts made while a person is alive.

[12] DUKEMINIER & JOHANSON, *supra* note 7, at 980.

[13] *Id.*

[14] *Id.* at 981.

[15] *Id.*

[16] The state death tax credit was later codified in 1954 as 26 U.S.C. § 2011. Jeffrey A. Cooper et al., *State Estate Taxes After EGTRRA: A Long Day's Journey into Night*, 17 QUINNIPIAC PROB. L.J. 317, 318 (2004).

[17] Eisenstein, *supra* note 7, at 232; Surkin, *supra* note 7, at 50.

[18] Surkin, *supra* note 7, at 50.

fied limits) by the amount of state death taxes paid.[19] Because of the nature of this credit, if a state levied a death tax that was less than the full value of the federal credit, the state left money on the table and effectively saved its citizens nothing because the federal government would keep the unused portion of the credit.[20] The state death tax credit became the foundation for many state death tax systems. Over the years, many states modified their death taxes to more fully take advantage of the federal credit by using a "pick-up" tax[21] in addition to or in lieu of any other death taxes.[22] The state death tax credit prior to EGTRRA involved a graded scale with a maximum credit of 16% of the value of a decedent's taxable estate.[23] This effectively created a situation where states would receive up to 16% of the total 55% pre-EGTRRA federal estate tax rate levied on large estates, while the federal government would keep the remaining 39%.[24]

II

EGTRRA's Changes to the Federal Estate Tax System

This close federal-state tie existed for nearly eighty years until the enactment of EGTRRA in 2001. EGTRRA affected all three wealth transfer taxes and many other areas of the tax code. EGTRRA made two major changes to the federal estate tax. First, each taxpayer's lifetime exemption from estate taxes gradually increases from $675,000 in 2001 to $3.5 million in 2009.[25]

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[19] Cooper et al., *supra* note 16, at 318.

[20] Stephen C. Hartnett, *Federal Estate Tax Changes Darken Nevada's Fiscal Future*, NEV. LAW., Sept. 2002, at 10, 10.

[21] A pick-up tax is created to fully absorb the amount of the available federal credit. Eileen Caulfield Schwab, *State Death Taxes Post-EGTRRA*, 325 PRACTISING L. INST. 583, 599 (2003); Surkin, *supra* note 7, at 50. Pick-up tax systems are also commonly known as "sop taxes" or "sponge taxes." *See, e.g.*, Schwab, *supra* at 599; Surkin, *supra* note 7, at 50. Prior to EGTRRA's enactment, all fifty states and the District of Columbia used some form of a pick-up tax. Cooper et al., *supra* note 16, at 318 & n.4.

[22] Cooper et al., *supra* note 16, at 318 & n.4; Surkin, *supra* note 7, at 50.

[23] 26 U.S.C. § 2011(b) (1994), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 531, 115 Stat. 38.

[24] *See* Cooper et al., *supra* note 16, at 323 tbl.3.

[25] *See* Ronni G. Davidowitz, *De-coupling the Federal and State Estate Taxes*, 330 PRACTISING L. INST. 407, 409-410 (2004). *Compare* Economic Growth and Tax Relief Reconciliation Act of 2001 § 521(a) (amending 26 U.S.C. § 2010), *with* Taxpayer Relief Act of 1997, Pub. L. No. 105-34 §501(a)(1)(B), 111 Stat. 788 (amending 26

Second, the maximum marginal estate tax rate gradually falls from 55% in 2001 to 45% in 2009.[26] Both types of relief conclude with the temporary repeal of all federal estate taxes in 2010.[27] Unless Congress takes further action, the sunset provisions built into EGTRRA will cause a reversion to pre-EGTRRA estate tax law in 2011.[28]

Congress also made changes to the federal gift tax by detaching the previously unified estate and gift taxes from each other.[29] EGTRRA increased the lifetime gift tax exemption to $1 million and fixed it at that level even though the estate tax exclusion continues to increase.[30] EGTRRA also detached the gift tax and estate tax rates by creating a separate table of gift tax rates with a maximum rate of 35%.[31] Lastly, unlike the estate tax, the gift tax is not repealed in 2010.[32] These changes may have implications for taxpayers and estate-planning practitioners because several considerations surrounding inter vivos gifts will change.

The GST was also changed by EGTRRA. First, in the years prior to 2010, the GST exemption amount increases in conjunction with the estate tax exemption to a maximum of $3.5 million in 2009.[33] Then, like the estate tax, the GST is scheduled for re-

U.S.C § 2010). The lifetime exemption comes in the form of a credit against the amount of taxes due. *See* 26 U.S.C. § 2010(a) (1994 & Supp. III 1997), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001 § 521(a). Subsequent references will refer to this credit as the "federal exemption" to minimize possible confusion with the state death tax credit.

[26] *See* Cooper et al., *supra* note 16, at 320. *Compare* Economic Growth and Tax Relief Reconciliation Act of 2001 § 511(a)-(c) (amending 26 U.S.C. § 2001), *with* 26 U.S.C. § 2001 (1994). Prior to EGTRRA, there was also a 5% surtax on amounts over $10 million, which was used to phase out the graduated rates on lesser amounts and make the tax rate a flat 55%. *See* 26 U.S.C. § 2001(c)(2) (Supp. III 1997), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001 § 511(b).

[27] *See* Economic Growth and Tax Relief Reconciliation Act of 2001 § 501(a) (creating 26 U.S.C. § 2210).

[28] *See id.* § 901(a)-(b). This sunset provision was designed to comply with the budget-deficit-spending restrictions imposed by the Byrd Rule. Cooper et al., *supra* note 16, at 320 & n.14.

[29] *See* Economic Growth and Tax Relief Reconciliation Act of 2001 § 511(a)-(d) (amending 26 U.S.C. §§ 2001, 2502).

[30] *See id.* § 521(a)-(b) (amending 26 U.S.C. §§ 2010, 2505).

[31] *See id.* § 511(d) (amending 26 U.S.C. § 2502).

[32] Davidowitz, *supra* note 25, at 411; *see* Economic Growth and Tax Relief Reconciliation Act of 2001 §§ 501(a), 511(d), 521(b)(2) (creating 26 U.S.C. § 2210 and amending 26 U.S.C. §§ 2502, 2505).

[33] *See* Economic Growth and Tax Relief Reconciliation Act of 2001 § 521(c) (amending 26 U.S.C. § 2631).

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peal in 2010.[34]

Along with the aforementioned modifications, EGTRRA makes two other significant changes that will affect states, taxpayers, and estate-planning practitioners. First, EGTRRA reduces the state death tax credit 25% per year during 2002-2004 and repeals it entirely in 2005, replacing the credit with a deduction.[35] There has been a massive ripple effect as states have responded to the direct effects of this change along with the indirect effects caused by EGTRRA's many other changes.[36] Along with the federal changes, the modifications that states have made to their own death tax regimes in response to EGTRRA have also affected planning considerations for taxpayers and estate-planning practitioners.

EGTRRA's second significant change relates to the tax basis of property acquired from a decedent. EGTRRA treats such property similar to gifts and eliminates the current full basis step-up in 2010.[37] Subject to exceptions, the basis of property acquired from a decedent will be the lesser of the decedent's adjusted basis or the property's fair market value on the decedent's date of death.[38] Two important exceptions to this new transferred basis rule exist. The first exception is a $1.3 million step-up allowed in the basis of property transferred to nonspouses.[39] The second exception is a $3 million step-up allowed in the basis of property transferred to spouses.[40] These changes technically have federal income tax implications, not estate tax implications, and they will not necessarily negatively impact the states.[41] However, these changes will have a marked effect on tax planning because taxpayers and practitioners will now have to take these new basis rules into account when planning for future transfers of property.

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[34] *See id.* § 501(b) (creating 26 U.S.C. § 2664).

[35] Cooper et al., *supra* note 16, at 318-19; *see* Economic Growth and Tax Relief Reconciliation Act of 2001 §§ 531-32(b) (amending 26 U.S.C. § 2011 and creating 26 U.S.C. § 2058).

[36] *See* Cooper et al., *supra* note 16, at 319.

[37] *See* Economic Growth and Tax Relief Reconciliation Act of 2001 §§ 541-42(a) (amending 26 U.S.C. § 1014 and creating 26 U.S.C. § 1022).

[38] 26 U.S.C.A § 1022(a) (West 2002).

[39] *Id.* § 1022(b)(2)(B).

[40] *Id.* § 1022(c)(2)(B).

[41] It is possible that state revenue will actually increase in states where the state income tax is tied to the amount of the federal adjusted gross income because gains on property that may be taxed upon sale under the new basis rules may not have otherwise been taxed under the old basis rules.

III

General Effects on the States due to EGTRRA's Changes to the Federal Estate Tax

The enactment of EGTRRA led many to believe that Congress was providing taxpayers a substantial amount of estate tax relief. Within EGTRRA, however, lies a somewhat unnoticed provision that has created major revenue implications for federal and state governments: the reduction and repeal of the state death tax credit.[42] The repeal of the state death tax credit ends the lengthy federal-state revenue-sharing arrangement and effectively shifts the burden of much of the lost tax revenue from the federal government to the individual states.[43] Several estimates place the total amount of lost state tax revenue between $50 and $100 billion over EGTRRA's ten-year expected life.[44]

This hidden shifting of the lost revenue is attributable to the nature of how the state death tax credit works and its relationship to the pick-up taxes that individual states created to absorb the credit. The state death tax credit was reduced 25% per year during 2002-2004 and was repealed in 2005.[45] As this has happened, the federal government has kept an increasing share of the federal estate tax levy, thus effectively shifting tax revenues from states to the federal government. Now that the state death tax credit has been repealed, the federal government will keep 100% of the estate tax levy for the years 2005-2009, and states with pick-up taxes based solely on the amount of the federal credit will have lost all death tax revenue. Even though the top marginal federal estate tax rate decreases from 55% to 45% during 2001-2007, the effective tax rate based on the proportion of tax revenue that the federal government actually receives *increased* from 39% to 47% during the 2002-2005 timeframe because of the effects of the reduction and elimination of the state death tax credit.[46] Although the actual tax rate paid to the federal government increases, the absolute amount of federal estate

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[42] *See* Economic Growth and Tax Relief Reconciliation Act of 2001 §§ 531-32 (amending and repealing 26 U.S.C. § 2011); Cooper et al., *supra* note 16, at 320.

[43] Cooper et al., *supra* note 16, at 320-21.

[44] *See id.* at 323 & n.18; Hartnett, *supra* note 20, at 10.

[45] *See* Economic Growth and Tax Relief Reconciliation Act of 2001 §§ 531-32 (amending and repealing 26 U.S.C. § 2011).

[46] *See* Cooper et al., *supra* note 16, at 322-23 & tbl.3; Schwab, *supra* note 21, at 601.

taxes paid by taxpayers should decline during the 2001-2009 timeframe because of the lower marginal estate tax rates and the higher federal exemption amounts that exist prior to the repeal of the federal estate tax in 2010.[47] However, as one author has put it, EGTRRA should be "more properly seen as a . . . modest federal tax cut combined with state tax eradication" rather than as a "massive federal tax cut."[48]

Through EGTRRA, Congress has forced states with pick-up taxes to respond to the repeal of the state death tax credit to avoid suffering the loss of tax revenue. The good news for the states is that Congress gave them several years to respond and adjust their tax systems because EGTRRA phases in the changes. However, many states have been slow to respond in the face of this inevitable loss of tax revenue, and state responses have varied based on a state's prior death tax system, its political climate, and even its constitutional limitations.[49]

There are many approaches to categorizing state responses to EGTRRA, but the approaches all appear to be variations on similar broad themes of remaining coupled to the federal death tax credit via a pick-up tax or decoupling in various ways from the federal estate tax system.[50] Because this Comment has an Oregon focus, a brief description of several common state approaches and their resulting effects on state tax revenues, estate administration, and estate planning, should suffice to provide background for further discussion of Oregon's response to EGTRRA.[51]

One common approach by states with pick-up taxes has been

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[47] *See* Cooper et al., *supra* note 16, at 320-22 & tbls.1-2. For a more in-depth analysis of this shifting of the tax burden, including several examples and tables, see *id.* at 320-23.

[48] *Id.* at 323.

[49] *See*, *e.g.*, *id.* at 324-30; Davidowitz, *supra* note 25, at 412-14 & app. A; Hartnett, *supra* note 20, at 10-11.

[50] *See, e.g.*, Cooper et al., *supra* note 16, at 330 (categorizing states as either pick-up states, partially decoupled states, or decoupled states); Davidowitz, *supra* note 25, at 412-14 (describing three categories similar to those used by Cooper); Hartnett, *supra* note 20, at 10 (describing three categories similar to those used by Cooper); Joel Michael, *State Responses to EGTRRA Estate Tax Changes*, 103 TAX NOTES 1023, 1025 (2004) (categorizing states as either pure pick-up states, pick-up states with automatic updates to federal law, pick-up states tied to federal law as of a specific date, and pick-up-plus-stand-alone tax states); Schwab, *supra* note 21, at 617-28 (creating six separate categories).

[51] For more detailed discussions of state responses to EGTRRA, see Cooper et al., *supra* note 16, Davidowitz, *supra* note 25, and Michael, *supra* note 50.

to do nothing and to remain tied to the amount of the federal death tax credit. This seems to have been the default approach for states since all of them utilized the federal credit to some extent. Several pick-up states, including Nevada and Florida, also have constitutional restrictions on decoupling.[52] Another approach by states has been to fully or partially decouple from the federal system in some manner. This has been done by either creating a completely separate state death tax system or by enacting changes to the state system while still basing underlying elements on the federal system.[53] All approaches have implications for a state's tax revenue, its estate tax administration, and estate planning by its residents.

The impact of these approaches on a state's tax revenue depends on how the state chooses to respond to EGTRRA. Pure pick-up states will see their death tax revenue completely eliminated by EGTRRA because of the reduction and elimination of the federal state death tax credit.[54] This loss of estate tax reve-

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[52] The Nevada Constitution allows the Nevada legislature to tax estates "to the extent of any credit allowed by federal law for the payment of the state tax." NEV. CONST. art. 10, § 4. However, a separate section prohibits the enactment of any inheritance tax. *Id.* § 1(7). Thus, a constitutional amendment would be required for Nevada to decouple from the federal estate tax system and create a separate state death tax. Such changes can be politically problematic. This is particularly bad for Nevada students because the tax revenues are "to be divided between the common schools and the state university for their support and maintenance." *Id.* § 4. The overall revenue loss to Nevada's K-12 schools, universities, and community colleges is estimated to total $26-$28 million annually. Hartnett, *supra* note 20, at 11. The 50% share designated for Nevada's university and community college system equates to over 7% of its recent budget. *Id.* This is a sizable amount of money shifted to the coffers of the federal government from the wallets of Nevada students (or taxpayers, should Nevada increase other taxes to make up for the loss).

Florida's Constitution similarly requires any state death tax to be coupled to the federal system. "No tax upon estates or inheritances . . . shall be levied by the state . . . in excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States . . . ." FLA. CONST. art. VII, § 5(a). Although current Florida law creates a pure pick-up tax based on the federal credit, FLA. STAT. § 198.02 (2004), the wording of Florida's constitution appears to allow more flexibility than Nevada's by allowing a state death tax in the amount of any allowable federal credit or deduction. Thus, Florida can likely make use of the new federal estate tax deduction with nothing more than a statutory change. Still, Florida is still constitutionally coupled to the federal system, and should the new federal deduction ever be repealed, Florida, like Nevada, would require a constitutional amendment to impose a death tax.

[53] *See, e.g.*, Cooper et al., *supra* note 16, at 324-29; Davidowitz, *supra* note 25, at 414.

[54] Cooper et al., *supra* note 16, at 331. See *supra* note 52 for a discussion of Nevada's revenue situation.

nue may be countered somewhat by the potential influx of new residents who may decide to move to such states because they no longer have a state death tax as of 2005.[55] Such residents would pay any applicable consumption, excise, property, and income taxes, thus helping to offset the loss of revenue from the defunct death tax.[56]

States that have fully decoupled from the federal system should suffer the least revenue loss from EGTRRA.[57] Assuming that their post-EGTRRA death tax systems are designed to generate approximately the same revenue as their pre-EGTRRA systems did, there should be little or no revenue loss.[58] States that have only partially decoupled from the federal system by maintaining ties to either the diminishing state death tax credit or the increasing federal exemption amount will suffer reasonably high revenue losses, as fewer estates will be taxed for lower amounts.[59]

Estate tax administration considerations also depend on a state's response. In the past, pick-up states have generally required a simple one-page state tax return to be filed in addition to the federal estate tax return.[60] The amount of state death tax owed was typically the amount of the state death tax credit from the federal return.[61] Even with the elimination of the federal credit in 2005, this process should not change, and the amount of state tax due will be zero.

In states with some form of decoupling, the administration becomes a bit more complex. For partially decoupled states, the extra administration considerations will depend on how the states have decoupled and what new paperwork they each require. For fully decoupled states and states that have exemption amounts different from the federal exemption amount, estate administrators may be required to file state estate tax returns even if no federal estate tax return is due.[62] Such returns may also be

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55 *Id.* at 332. For further insight into EGTRRA's impact on a taxpayer's choice of domicile, see also Surkin, *supra* note 7, and discussion *infra* Part VI.C.

56 Cooper et al., *supra* note 16, at 332.

57 *Id*. at 330.

58 *Id.*

59 *Id.* at 331.

60 *Id*. at 332; *see*, *e.g.*, OREGON INHERITANCE TAX FORM IT-1 (2001), *available at* http://egov.oregon.gov/DOR/BUS/forms-fiduciary.shtml (last visited June 29, 2005).

61 Cooper et al., *supra* note 16, at 332; *see, e.g.*, OREGON INHERITANCE TAX FORM IT-1, *supra* note 60.

62 Cooper et al., *supra* note 16, at 333.

more complicated if they materially differ from the federal estate tax return or are based on pre-EGTRRA federal law, thus necessitating calculation of a pro forma federal return based on the pre-EGTRRA law in addition to the required federal estate tax return.[63] Moreover, former pick-up states must create systems to audit and enforce tax returns for compliance and to address property valuation concerns because they can no longer rely on the federal government to do this work for them.[64] These additional administrative burdens will create extra costs for both the taxpayers and the states.

Estate-planning implications will also vary based on a state's response to EGTRRA. Post-EGTRRA estate-planning implications for residents of pick-up states are relatively minimal. Since these states remain tied to federal law, any plan designed to minimize federal estate taxes should generally minimize any state taxes.[65] However, taxpayers should still consider, among other things, property they own outside of their state of domicile, the changes to the tax basis rules for property transfers upon death, and whether to make inter vivos gifts of property, which are often treated differently for state and federal purposes.[66]

For taxpayers domiciled in fully decoupled states or states that have exemption amounts different from the federal exemption amount, estate planning has become significantly more compli-

[63] *Id*. Mr. Cooper provides two examples where state and federal law may differ in the post-EGTRRA era. The first example is the expanded federal exclusion for conservation easements from the decedent's gross estate. *Id.*; *see also* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 551, 115 Stat. 38 (amending 26 U.S.C. § 2031). The second example is the elimination of the deduction for the amount of Qualified Family Owned Business Interests from the decedent's taxable estate. Cooper et al., *supra* note 16, at 333; *see also* Economic Growth and Tax Relief Reconciliation Act of 2001 § 521(d) (repealing 26 U.S.C. § 2057). Both changes ultimately affect the definition of the federal taxable estate, which would then differ from the definition of the taxable estate for state death tax purposes in states that do not mirror the federal changes.

[64] *See* Cooper et al., *supra* note 16, at 333; Telephone Interview with Charles J. McMurchie, of Counsel, Stoel Rives LLP (Feb. 17, 2005). Mr. McMurchie, a long-time Oregon practitioner, noted that, when state and federal filing thresholds were the same and states just used a pick-up tax, the states piggybacked their auditing processes onto the federal government by letting the IRS handle the auditing and valuation problems. *Id*. Newly decoupled states with filing thresholds lower than the federal exemption will now have to devote resources both to auditing estate tax returns and to resolving property valuation disputes that often arise over hard-to-value property such as real estate and interests in LLCs. *Id.*

[65] Cooper et al., *supra* note 16, at 334.

[66] *See infra* Part VI.C for further discussion of these considerations.

cated under EGTRRA. Typically, when federal and state exemption amounts were linked, a credit shelter trust would be used to devise property in an amount equal to the federal credit amount.[67] The remainder would qualify for the unlimited marital deduction, thus deferring estate taxes until the death of the second spouse, and any remaining property not qualifying for the marital deduction would be taxed.[68] In states where the federal and state exemptions are no longer linked, however, such plans may trigger unintended state tax consequences. If the federal exemption under EGTRRA increases to a higher level than the state exemption, then state taxes may well be due on the difference between the federal and state exemption amounts.[69] This complicates the use of credit shelter trusts, and taxpayers may want to consider using disclaimers and Qualified Terminable Interest Property (QTIP) elections to provide additional flexibility.[70] Furthermore, when creating and implementing an estate plan, taxpayers will want to consider EGTRRA's changes to the laws surrounding inter vivos gifts and to the tax basis rules for property transfers upon death. Likewise, taxpayers should also consider the domicile of their property because states often treat property owned by nonresidents differently for tax purposes than property owned by their residents.[71]

IV

A Historical Overview of Oregon's Inheritance Tax System

Oregon first enacted an inheritance tax in 1903.[72] The original

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[67] *E.g.*, Cooper et al., *supra* note 16, at 334. For more discussion of the use of credit shelter trusts for estate planning, see *infra* Part VI.A.

[68] *E.g.*, Cooper et al., *supra* note 16, at 334-35.

[69] *E.g., id.*

[70] The estate-planning uses of credit shelter trusts, QTIP elections, and disclaimers will be discussed in more detail in Part VI.A-B of this Comment *infra.*

[71] These planning considerations will be discussed in more detail in Part VI.C of this Comment *infra*.

[72] Act of Feb. 16, 1903, 1903 Or. Gen. Laws 49. Oregon's original death tax was an inheritance tax. *See* § 2 (stating that the tax is levied on property "received by each person"). Although called an inheritance tax, Oregon currently levies an estate tax because it is tied to the federal estate tax levied on the estate of the decedent, not on the recipient of the transferred property. *See* Or. Rev. Stat. § 118.010(2) (1993); Oregon Inheritance Tax Return Form IT-1, 1 (2004), *available at* http://egov.oregon.gov/DOR/BUS/forms-fiduciary.shtml (last visited June 29, 2005) [hereinafter Tax Return Form]. For definitions of inheritance and estate taxes, see *supra* note 7. This being noted, the author will defer to the Oregon legislature's

tax rate ranged from 1% to 6% based on the recipient's relationship to the decedent and the amount of property received.[73] Not surprisingly, the Oregon legislature amended the inheritance tax many times over the years, leading to a general increase in the complexity and rates of Oregon's inheritance tax system.[74] In 1971, Oregon tied its inheritance tax system to the federal system by adopting a pick-up tax based on the state death tax credit.[75] The new pick-up tax was levied in addition to the basic inheritance tax and amounted to the difference between the federal credit and Oregon's basic inheritance tax.[76] Thus, the pick-up tax became a floor for the amount of tax due.

By 1975, Oregon's transfer tax system was quite complex. Oregon levied a gift tax[77] in addition to its inheritance tax, and its inheritance tax rates ranged from 3% to 25% based on the amount transferred and the recipient's relationship to the decedent.[78] Up to $300,000 of property could be transferred to a surviving spouse or to a minor or disabled child via a credit.[79] The pick-up tax based on the federal credit still served as the floor for the amount due.[80]

In 1977, the Oregon legislature radically changed and simplified Oregon's inheritance tax system. The former myriad of inheritance tax rates was simplified by implementing a flat 12%

choice of terminology, and all subsequent references to Oregon's death tax will use the term "inheritance tax."

73 Act of Feb. 16, 1903, § 2, 1903 Or. Gen. Laws 49, 50-51. For estates valued at $10,000 or more, property passing to a decedent's parents, spouses, children, siblings, adopted children, daughter's husbands, and son's wives or widows was taxed at a rate of 1% on the amount of property received by such persons in excess of $5000 each. *Id.* Property passing to a decedent's uncles, aunts, nieces, nephews, or any of their descendants was taxed at a rate of 2% on the amount of property received by such persons in excess of $2000 each. *Id.* Property passing to all other persons was taxed at a rate of 3% on amounts between $501 and $10,000, 4% on amounts between $10,001 and $20,000, 5% on amounts between $20,001 and $50,000, and 6% on amounts over $50,000. *Id.*

74 The first such amendment came in 1909. *See* Act of Feb. 5, 1909, ch. 15, § 1, 1909 Or. Gen. Laws 60, 60-61 (amending Oregon's inheritance tax to include grandparents in the list of relations in the 1% tax bracket and creating an exemption for estates valued at less than $5000 for property passing to relations in the 2% tax bracket).

75 Act of July 1, 1971, ch. 732, § 4, 1971 Or. Laws 1767, 1768-69.

76 *Id*.

77 *See* OR. REV. STAT. ch. 119 (1975). Oregon's gift tax was completely repealed in 1997. *See* Act of Oct. 4, 1997, ch. 99, § 54, 1997 Or. Laws 179, 201.

78 *See* OR. REV. STAT § 118.100(1)-(3) (1975).

79 *Id.* § 118.035.

80 *Id.* § 118.100(4).

rate for all transfers to beneficiaries of the decedent.[81] The credit for transfers to spouses and minors was slowly phased out over ten years and was replaced by an increasing exemption for all transfers.[82] An even more important change was that the inheritance tax rate became zero at the end of the ten-year period.[83] Thus, on January 1, 1987, Oregon's inheritance tax system became based on a pure pick-up tax.[84] In 1997, the Oregon legislature revised the transfer tax laws again, creating Oregon's pre-EGTRRA inheritance tax framework and repealing the state gift tax.[85]

Although Oregon's inheritance tax system has been based on federal law via the pick-up tax, it is not automatically connected to changes in federal law. While Oregon's legislature can draft its laws and regulations to adopt existing laws of other states or the federal government, it cannot create a connection to another body of law such that future changes to that law will automatically change Oregon's laws.[86] Thus, coordination or adoption of another body of law must be done via reference to such law as it exists on a specific date, which means that Oregon is fully decoupled from the federal estate tax system unless the legislature acts affirmatively to couple its inheritance tax to the federal system.

Ever since the 1971 pick-up tax was adopted to take advantage of the state death tax credit, Oregon's legislature has always acted to keep the inheritance tax coupled to federal law. Each time Congress changes the federal estate tax, Oregon's legislature must continue to act to keep Oregon's inheritance tax coupled to federal law if the legislature's intent is for Oregon to remain coupled.

EGTRRA has created interesting implications for Oregon because of its sweeping changes and the fact that Oregon must always act to remain coupled to federal law. The next several sections of this Comment will discuss the initial impact of EGT-

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[81] Act of July 26, 1977, ch. 666, § 9, 1977 Or. Laws 620, 624-25.

[82] *Id.* §§ 4, 9 at 622-24.

[83] *Id.* § 9 at 624.

[84] *See id.*

[85] *See* Act of Oct. 4, 1997, ch. 99, 1997 Or. Laws 179 (amending OR. REV. STAT. § 118.010 to specifically reference the state death tax credit in 26 U.S.C. § 2011 and repealing Oregon's gift tax in OR. REV. STAT. ch. 119).

[86] Seale v. McKennon, 215 Or. 562, 572, 336 P.2d 340, 345 (1959) (holding that automatic adoption of future modifications to a specifically referenced federal law is an unconstitutional delegation of legislative authority).

RRA on Oregon, Oregon's responses to EGTRRA, the resulting estate-planning implications for taxpayers and practitioners, and the possible effects of currently proposed inheritance tax legislation.

V

EGTRRA'S EFFECTS ON OREGON AND OREGON'S INITIAL RESPONSES

The State of Oregon and its residents have been affected by EGTRRA in numerous ways, many of which are similar to those felt by other states. Because of its use of a pick-up tax, Oregon faced the prospect of losing tax revenue due to EGTRRA's reduction and elimination of the state death tax credit. Like many states, Oregon runs on a shoestring budget, and any potential loss of tax revenue does not bode well for the prospect of providing needed services to its residents. Oregon's inheritance tax receipts become part of Oregon's General Fund and can be used to "meet any expense or obligation of [the] state."[87] In the 2001-2003 biennium, Oregon's inheritance tax generated $116.6 million in revenue and was the third largest source of tax revenue for the General Fund after taxes on personal income and corporations.[88] In the first half of the 2003-2005 biennium, Oregon has

[87] OR. REV. STAT. § 118.510 (2003). In the 2001-2003 biennium, Oregon's General Fund budget was $9.597 billion, and the three largest categories of General Fund expenses were Education, $5.211 billion; Human Resources, $2.387 billion; and Public Safety, $1.231 billion. LEGISLATIVE REVENUE OFFICE, 2005 OREGON PUBLIC FINANCE: BASIC FACTS, RESEARCH REPORT #1-05 A11 tbl.10 (2005), *available at* http://www.leg.state.or.us/comm/lro/publications.htm (last visited June 29, 2005) [hereinafter BASIC FACTS]. In the 2003-2005 biennium, Oregon's General Fund budget was $10.191 billion, and the three largest categories of General Fund expenses were Education, $5.910 billion; Human Resources, $2.286 billion; and Public Safety, $1.214 billion. *Id.*

[88] BASIC FACTS, *supra* note 87, at F1. Transfer taxes are inherently volatile. *Id.* Over the past three decades, the tax revenue generated by Oregon's transfer taxes has ranged from $12,613,154 in fiscal year 1970-1971 to $73,609,092 in fiscal year 2003-2004. *Id.* at A3 tbl.4. Fiscal year 2003-2004 was the year with the greatest amount of transfer tax revenue, while the low point of $8,875,434 was reached in fiscal year 1988-1989. *Id.* at F3. Even with this inherent volatility, the amount of revenue from such taxes has steadily increased over time due to increasing property values and an increase in the elderly population. *Id.* at F1. The only noticeable downward trend occurred after the 1977 changes to Oregon's inheritance tax system, which phased out the statutory tax over a ten-year period. *See id*. at F3. The 1988-1989 low point came after the complete termination of Oregon's statutory inheritance tax in 1987.

so far collected $73.6 million in inheritance taxes.[89] Thus, the inheritance tax is vitally important to Oregon.

A. EGTRRA and the Road to HB 3072

Because Oregon's inheritance tax system is not directly coupled to the federal system but is tied to it as of a specific date, there were no immediate effects on Oregon's inheritance tax system when EGTRRA was enacted. The story, however, is not quite so simple. Prior to EGTRRA, there was already confusion regarding which federal laws Oregon had adopted and as of what date Oregon's inheritance tax laws were tied to the corresponding federal estate tax laws. Prior to 1997, the threshold for filing an Oregon inheritance tax return was tied to the federal filing threshold based on the $600,000 federal exemption.[90] The Taxpayer Relief Act of 1997 (TRA97) gradually increased the federal exemption to $1 million by 2006.[91] Because Oregon's statute did not require taxpayers to file a state inheritance tax return unless they filed a federal return, the increasing federal exemption under TRA97 meant that taxpayers would file fewer returns, fewer estates would be taxed, and those estates that were taxed would pay a lesser amount of tax.

After TRA97 was passed, however, questions arose as to whether Oregon had actually adopted the higher exemption amounts and the other changes embodied in TRA97.[92] Prior to 2001, the Oregon Department of Revenue (ODR) had adopted the stance that Oregon would comply with the higher exemption requirements under TRA97, which was adopted on August 5, 1997.[93] However, after EGTRRA was passed, there was confusion at the ODR regarding the exact tie-in date to federal law.[94] After reviewing the legislative history of the inheritance tax statute, it was determined in 2001 that Oregon's inheritance tax sys-

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[89] *See* BASIC FACTS, *supra* note 87, at A3 tbl.4.

[90] BASIC FACTS, *supra* note 87, at F1; *see also* 26 U.S.C. §§ 2001(b), 2010(a) (1994); OR. REV. STAT § 118.160(1) (1995).

[91] Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 501(a)(1)(B), 111 Stat. 788; BASIC FACTS, *supra* note 87, at F2.

[92] *See, e.g.*, BASIC FACTS, *supra* note 87, at F2; Jeffery M. Cheyne, *Oregon Estate Tax Warning ORS 118.010*, OR. EST. PLAN. & ADMIN. SEC. NEWSL., Apr. 2002, at 8 (on file with author).

[93] BASIC FACTS, *supra* note 87, at F2; Cheyne, *supra* note 92, at 8.

[94] Cheyne, *supra* note 92, at 8; Jeffery M. Cheyne, *Oregon Inheritance Tax Update: HB 2184*, OR. EST. PLAN. & ADMIN. SEC. NEWSL., Apr. 2003, at 7 (on file with author).

tem was tied to federal law as of April 28, 1997.[95]

Once this tie-in date was determined, there still remained a need to clarify the effects that this change would have on past and future taxpayers. Since January 1998, the ODR had been administering the inheritance tax as if Oregon had adopted the higher federal exemptions under TRA97 instead of the $600,000 exemption that was effective as of April 28, 1997.[96] This put Oregon taxpayers in limbo, and the subsequent enactment of EGTRRA in 2001 sparked an additional push for Oregon's legislature to amend the inheritance tax code to connect to EGTRRA in some form.[97] Several bills were introduced in subsequent legislative sessions that would have clarified the ODR's handling of the administrative disjunctions for the years 1998-2001, and also would have amended Oregon's inheritance tax code to tie it to the more recent federal changes.[98] Most of these bills also would have ultimately repealed Oregon's inheritance tax.[99] After much debate, the legislature finally reached a consensus, enacting House Bill 3072 (HB 3072) on September 24, 2003.[100]

B. HB 3072: Current Oregon Law

HB 3072 was designed to clear up the administrative confusion surrounding the date of Oregon's tie-in to federal law and to officially couple Oregon's system to the changes made by TRA97.[101] It did this by retroactively adopting TRA97's changes for deaths occurring between 1998 and 2001.[102] HB 3072 also adopted December 31, 2000, as the new tie-in date to federal law for tax years beginning in 2003.[103] Thus, as of this writing, Oregon has adopted the changes to federal law within TRA97 but has not

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95 Cheyne, *supra* note 94, at 7.

96 Cheyne, *supra* note 92, at 8.

97 *See, e.g.*, Cheyne, *supra* note 94, at 10.

98 For further discussion of the purposes and effects of several of these bills, including House Bill (HB) 2184, HB 2503, HB 2704, and Senate Bill (SB) 632, see Cheyne, *supra* note 94, at 8-10. For a brief discussion of HB 4077, which was adopted and later vetoed by Governor Kitzhaber, see also Jeffery M. Cheyne, *Oregon Estate Tax Update*, OR. EST. PLAN. & ADMIN. SEC. NEWSL., Oct. 2002, at 10 (on file with author), and Stephen J. Klarquist, *Governor Kitzhaber Pulls the Plug on Inheritance Tax Reconnect*, OR. EST. PLAN. & ADMIN. SEC. NEWSL., Jan. 2003, at 7 (on file with author).

99 Cheyne, *supra* note 94, at 10.

100 *See* Act of Sept. 24, 2003, ch. 806, 2003 Or. Laws 3399.

101 *Id*. § 1a.

102 *See id*. §§ 2-3.

103 *Id*. § 2.

adopted the changes within EGTRRA.[104]

HB 3072 has had many effects on Oregon and its residents. First, it has caused a negative impact on the state's tax revenue. HB 3072 is estimated to cost Oregon's General Fund $3 million in tax revenue during the 2003-2005 biennium and $10.3 million during the 2005-2007 biennium.[105] This is no small sum in the era of tight budgets. Although these figures are the estimated fiscal impact of adopting the federal changes within TRA97, there is continuing pressure on the legislature to reduce or eliminate Oregon's inheritance tax by tying it to EGTRRA. Should that happen, it is estimated that the revenue loss to Oregon's General Fund would increase to $66 million in the 2003-2005 biennium and $88 million in the 2005-2007 biennium.[106] This is a sizable amount of money that equates to 0.7% and 0.9% of the respective biennial General Fund budgets.[107] To put those figures into a larger perspective, they are greater than the amounts allocated

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[104] *See* BASIC FACTS, *supra* note 87, at F2.

[105] LEGISLATIVE REVENUE OFFICE, REVENUE MEASURES PASSED BY THE 2003 LEGISLATURE, RESEARCH REPORT #4-03 53 (2003), *available at* http://www.leg.state.or.us/ comm/lro/publications.htm (last visited June 29, 2005).

[106] LEGISLATIVE REVENUE OFFICE, REVENUE IMPACT OF H.R. 1836: THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001, RESEARCH BRIEF #3-01 2 (2001), *available at* http://www.leg.state.or.us/comm/ lro/publications.htm (last visited June 29, 2005) [hereinafter REVENUE IMPACT OF H.R. 1836]. These numbers are based on the pure reduction and elimination of Oregon's inheritance tax that would occur if the Oregon legislature adopted the changes within EGTRRA. The overall estimated impact to Oregon's General Fund revenue would be mitigated somewhat due to the automatic feedback effect on Oregon's income tax caused by the changes to the federal income tax law contained in EGTRRA. *See id.* After accounting for all of the effects on Oregon's tax revenue from fully adopting EGTRRA, the total loss of tax revenue to Oregon is estimated to be $32.2 million in the 2003-2005 biennium and $22.7 million in the 2005-2007 biennium. *Id.*

So far, Oregon will likely receive a *positive* revenue impact from the enactment of EGTRRA with an estimated *increase* in General Fund revenue of $39.6 million in the 2001-2003 biennium, $33.8 million in the 2003-2005 biennium, and $65.3 million in the 2005-2007 biennium because of the feedback effect. *Id.* As with most tax estimates, however, these positive estimates may have been fleeting. The Job Creation and Worker Assistance Act of 2002, which Congress passed a year after EGTRRA, was initially estimated to cost Oregon $148 million in lost revenue in the 2001-2003 biennium and $93 million in the 2003-2005 biennium before providing an increase of $84 million in tax revenue in the 2005-2007 biennium. LEGISLATIVE REVENUE OFFICE, OREGON INCOME TAX RECONNECT AND "THE JOB CREATION AND WORKER ASSISTANCE ACT OF 2002," RESEARCH BRIEF #3-02 (updated) 2 (2002), *available at* http://www.leg.state.or.us/comm/lro/ publications.htm (last visited June 29, 2005). For a succinct discussion of the revenue impact of EGTRRA and its reconnect and feedback effects on Oregon's income tax system, see REVENUE IMPACT OF H.R. 1836, *supra*.

[107] *See* BASIC FACTS, *supra* note 87, at A11. These percentages are based on the

to fund the state legislature in each biennium and equate to about one-fifth of the amounts allocated to the state judiciary.[108]

The unfortunate thing for Oregon taxpayers is that the state budget is not the only thing affected by HB 3072. A somewhat more subtle effect on Oregon taxpayers is that EGTRRA will actually cost them real money. Even though Oregon still bases its inheritance tax on the federal exemptions and the state death tax credit in effect under TRA97, EGTRRA's repeal of the state death tax credit will cost taxpayers more money out of pocket. The reason for this is that with the repeal of the state death tax credit, the revenue-sharing arrangement between the federal and state governments has ended. Oregon taxpayers will no longer owe one lump sum to be shared between the federal and state governments. Instead, Oregon taxpayers will now owe separate amounts to each revenue-hungry government, mitigated only by EGTRRA's creation of a deduction for state death taxes to replace the now-defunct state death tax credit.[109]

For example, as of 2005, a $10 million Oregon taxable estate under pre-EGTRRA federal law would have owed $5,084,500 in federal estate taxes but would have received a state death tax credit of $1,067,600.[110] Thus, $4,016,900 would have been paid to the federal government, and Oregon would have collected $1,067,600, the amount of the state death tax credit. The federal government would have kept 79% of the total tax levy and shared the remaining 21% with Oregon via the credit.

The same $10 million estate under current federal (EGTRRA) and Oregon (TRA97) law, however, would pay $3,493,228 to the federal government and would still owe Oregon $1,067,600, the amount of the state death tax credit under TRA97.[111] Although the total amount of death taxes due is $4,560,828, an 11% actual

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pure elimination of Oregon's inheritance tax and do not consider any possible feedback effect discussed in note 106.

108 *See* Basic Facts, *supra* note 87, at A11.

109 *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 532(a)-(b), 115 Stat. 38 (repealing 26 U.S.C. § 2011 and creating 26 U.S.C. § 2058).

110 These calculations use TRA97's marginal estate tax rate of 55% on estates over $3 million, TRA97's federal exclusion of $950,000 in 2005, and include the $60,000 deduction from the taxable estate when computing the amount of the state death tax credit.

111 These calculations use EGTRRA's marginal estate tax rate of 47% on estates over $2.5 million, EGTRRA's federal exclusion of $1.5 million in 2005, and include the $60,000 deduction from the taxable estate when computing the amount of the state death tax credit.

reduction from the pre-EGTRRA scenario, this reduction can be attributed to the increase in the federal exemption and the lower tax rates under EGTRRA. Had EGTRRA not repealed the state death tax credit, the total taxes due would have been $3,995,000, with $2,927,400 of this amount being paid to the federal government and $1,067,600, the amount of the state death tax credit, being paid to Oregon.[112] Interestingly, without EGTRRA's lower marginal tax rates and higher exemption, the total taxes due would have been $5,294,920, with $4,227,320 of this amount being paid to the federal government and the $1,067,600 state death tax credit amount being paid to Oregon.[113] This result is actually an increase of $210,420 over the amount due under TRA97 in the first example—a 4% increase in total taxes due.

These examples demonstrate how EGTRRA has created a shift in the total tax burden imposed by the federal government and decoupled states that now levy a separate death tax. Because each level of government now levies a separate tax—at least until the federal estate tax is repealed in 2010—rather than sharing the single federal estate tax via the state death tax credit, the additional state tax burden comes out of the wallets of Oregon's residents, not out of the federal treasury.

Administration of Oregon estates has become more complicated since Oregon's inheritance tax system decoupled from the federal system. Prior to HB 3072, an executor was required to file an Oregon inheritance tax return only if a federal return was required.[114] Under HB 3072, Oregon's filing threshold is lower than the current federal filing threshold, and this difference has

[112] These calculations use EGTRRA's marginal estate tax rate of 47% on estates over $2.5 million, EGTRRA's federal exclusion of $1.5 million in 2005, and include the $60,000 deduction from the taxable estate when computing the amount of the state death tax credit. They also remove the newly created deduction for state death taxes under 26 U.S.C. § 2058 and instead include 100% of the state death tax credit.

[113] These calculations use TRA97's marginal estate tax rate of 55% on estates over $3 million, TRA97's federal exclusion of $950,000 in 2005, and include the $60,000 deduction from the taxable estate when computing the amount of the state death tax credit. They also include the newly created deduction for state death taxes under 26 U.S.C. § 2058 and do not include the former state death tax credit. The purpose behind these calculations is to compare the value of the state death tax credit against the value of new federal deduction. In this case, the deduction is worth $210,420 less than the credit. But more importantly, the amount of the credit is still owed to Oregon because it is decoupled from the federal system, so the actual death tax bill would be $210,420 *greater* under this scenario.

[114] OR. REV. STAT. § 118.160 (2001).

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administrative implications for both the state and its taxpayers.[115] For taxpayers, an Oregon inheritance tax return must be filed if the estate's value exceeds HB 3072's exemption amount, even if a federal return is not required, because the estate's value is less than the current federal threshold. Oregon also "requires the same forms, schedules, and supporting information . . . as would have been required, had the estate been required to file by federal law."[116] Therefore, the executor of an Oregon estate must also complete the paperwork necessary for a full federal filing even if one is not due.[117] Additionally, Oregon's inheritance tax form has grown from a simple ten-line, one-page form with a single page of instructions in 2001 to a complex three-page form with fourteen pages of instructions in 2004.[118] For the state, these requirements mean that the ODR must now handle the auditing and valuation issues related to Oregon estates that are not large enough to require a federal filing.[119] The result of Oregon's decoupling from federal law under HB 3072 has meant an increase in the time and cost of administering an Oregon estate.

VI

Estate-Planning Implications for Oregon Residents

This section will delve more deeply into the estate-planning problems generated by EGTRRA and by Oregon's decoupling from the federal estate tax system.[120] The first part of the discus-

115 *See* Or. Rev. Stat. § 118.160 (2003); Tax Return Form, *supra* note 72, at 1. HB 3072 changed Oregon's filing threshold to $700,000 in 2003, $850,000 in 2004, $950,000 in 2005, and $1 million in 2006. Act of Sept. 24, 2003, ch. 806, § 7, 2003 Or. Laws 3399, 3400-01.

116 Tax Return Form, *supra* note 72, at 1.

117 Oregon also still appears to allow a deduction for Qualified Family Owned Business Interests because it is tied to federal law as of December 31, 2000. *See* Or. Rev. Stat. § 118.120 (2003); Tax Return Form, *supra* note 72, at 6. The equivalent federal deduction has since been repealed by EGTRRA. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(d), 115 Stat. 38 (repealing 26 U.S.C. § 2057). Thus, the definition of a taxable estate under Oregon and federal law is necessarily different, which may also create further complications. *See supra* note 64.

118 *Compare* Oregon Inheritance Tax Return Form IT-1 (2001), *available at* http://egov.oregon.gov/DOR/BUS/forms-fiduciary.shtml (last visited June 29, 2005), *with* Tax Return Form, *supra* note 72.

119 *See supra* note 65 and accompanying text.

120 The discussion will necessarily be tilted toward the presumption that the changes created by EGTRRA and Oregon's decoupling from the federal estate tax system will remain permanent even though EGTRRA's changes are scheduled for

sion will address EGTRRA's impact on traditional credit shelter trust arrangements, their funding, and the use of QTIP elections and disclaimers to provide additional flexibility. The next part of the discussion will focus on the implications of EGTRRA's new cost basis rules, EGTRRA's impact on a taxpayer's choice of domicile, and the effect of the gift tax changes on the use of inter vivos gifts for tax planning purposes.

A. Credit Shelter Trusts: Background and the Implications of Decoupling

Both EGTRRA and Oregon's choice to decouple from the federal estate tax via HB 3072 have affected the traditional use of credit shelter trusts for estate planning. Credit shelter trusts have traditionally been used by married couples as a means of ensuring that both spouses fully utilize their exemption from the federal estate tax, which comes in the form of the unified gift and estate tax credit, without generating estate tax liability upon the death of the first spouse.[121] By creating a trust for the surviving spouse that qualifies for the marital deduction and funding it with assets up to the amount of the first spouse's unused exemption, a married couple can arrange for these assets to pass free of the estate tax when the first spouse dies.[122] If the trust is appropriately drafted so that the surviving spouse has less than absolute control over the trust assets, then the assets will not be included in the surviving spouse's gross estate upon death.[123] Typically, credit shelter trusts permit discretionary distributions of principal and income to the spouse and children and name the children as remainder beneficiaries.[124] Credit shelter trusts can be used to provide what is essentially a life estate (subject to the trust's restrictions) to the surviving spouse, and the remaining as-

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repeal in 2011. Should this repeal occur, Oregon's inheritance tax system will become effectively recoupled to the federal system (barring any further changes by the Oregon legislature). Over the next several years, it would be wise for Oregon taxpayers to review their estate plans frequently.

[121] *See* Pareja, *supra* note 2, at 81.

[122] *See id.* at 81-82; Barbara A. Sloan, *Planning with the Phase-out of the State Death Tax Credit: Working with the Credit Shelter Bequest after EGTRRA*, SK001 A.L.I.-A.B.A. 1447, 1463 (2004).

[123] Pareja, *supra* note 2, at 81. Admittedly, this is an oversimplification regarding the surviving spouse's control. However, the use of credit shelter trusts is common and well understood by estate planners. For a more in-depth discussion of the historical and current uses of credit shelter trusts in estate planning, see *id.* at 80-83, and Sloan, *supra* note 122.

[124] Sloan, *supra* note 122, at 1463.

sets will pass free of estate taxes.[125] The remaining estate passes to the spouse in a form qualifying for the marital deduction—either outright or via a power of appointment or QTIP trust.[126]

The key to credit shelter planning is to use the federal exemption of the first spouse when the assets pass to the second spouse rather than using the marital deduction.[127] Upon the surviving spouse's death, the credit shelter trust corpus is excluded from the spouse's estate, and the remaining assets that had previously passed to the surviving spouse via the marital deduction are protected to the limit of the surviving spouse's own exemption.[128] Thus, by funding a trust to the limits of the federal exemption, the first spouse's exemption is "sheltered" from being lost upon death, and the assets in the credit shelter trust can pass free of estate taxes when both spouses die.[129] Because of the ability to fully use both spouses' exemptions while retaining a reasonable amount of flexibility, credit shelter trusts became the method of choice for tax planning.[130]

When a state was coupled to the federal system and state death taxes were due only when federal estate taxes were due, there was no added complexity to using credit shelter trusts as a planning tool. However, with Oregon's decoupling of its exemption from the federal exemption, several interrelated layers of complexity have been added to the use of credit shelter trusts. The first layer of complexity is created because formulas are often used to fund credit shelter trusts, and the second layer of complexity is caused by the different federal and state exemption amounts under EGTRRA and Oregon's HB 3072.

Oregon's decoupled status has made the funding of credit shelter trusts more complex than in the past. Because it is usually impossible to know how much of the lifetime exclusion a client will have at the time of death, wills and trusts often use formulas rather than specific amounts as a means of expressing bequests.[131] Three types of formulas are typically used to fund

125 Pareja, *supra* note 2, at 81.

126 Sloan, *supra* note 122, at 1463-64.

127 *See* Pareja, *supra* note 2, at 81 & n.44.

128 *See id.*; Sloan, *supra* note 122, at 1464.

129 Pareja, *supra* note 2, at 81-82.

130 *Id.* at 82.

131 Sloan, *supra* note 122, at 1464. Some of the lifetime exemption may have been used if the spouse had made inter vivos gifts or if the amount of the available exemption had changed since the estate plan was created. *Id.*

credit shelter trusts. The first type of formula creates a credit shelter trust with a preresiduary bequest, and the residue then passes via the marital deduction—either outright or into a QTIP trust.[132] The second formula type reverses this process, combining an outright or QTIP preresiduary bequest with a residuary bequest, which then passes into the credit shelter trust.[133] A third option divides the residue itself into two shares.[134] One share is based on the federal exemption amount and passes into the credit shelter trust, and the other share passes outright or into a QTIP trust.[135]

Several issues occur when using such formulas. First, when either one of the first two methods is used, it is usually preferable for the smaller amount to be the preresiduary bequest because this is likely to minimize any recognition of capital gains.[136] EGTRRA introduces extra complexity into the process because of its increases to the federal exemption amount, which may cause the relative size of the two bequests to reverse.[137] It is not practical to draft a will to account for all of these changes, so unless an estate is very large, practitioners may wish to avoid the use of formulas, or, alternatively, they might want to introduce a dollar cap into any formula to ensure that the federal exemption is used appropriately.[138]

The difference between the amount of the federal exemption and Oregon's exemption also creates a second set of problems for Oregon taxpayers and estate planners. Because Oregon has a lower exemption level than the federal government, Oregon's taxes may need to be filed and paid even when federal taxes do not. Thus, a credit shelter trust created to take advantage of the higher federal exemption may trigger state taxes for the amount exceeding Oregon's exemption. This problem affects existing trusts created prior to Oregon's decoupling in addition to complicating the creation of future trusts. The alternative to fully using the federal exemption is to cap the credit shelter trust by funding it only to the level of Oregon's exemption. In doing so, the full amount will pass free of both federal and Oregon taxes, but the

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[132] *Id.*
[133] *Id*.
[134] *Id*.
[135] *Id*.
[136] *Id.* at 1464-65.
[137] *Id.* at 1465.
[138] *Id*.

tax savings on the difference between the federal exemption and the Oregon exemption would then be lost. Neither choice is necessarily savory to the taxpayer, so the consequences of each scenario should be well understood by the taxpayer prior to making a decision regarding either approach.

B. Credit Shelter Trusts: Using Disclaimers and QTIP Elections to Provide Flexibility

Because of Oregon's decoupled status and the uncertainty surrounding the future of the federal estate tax, taxpayers and estate-planning practitioners may wish to consider the use of disclaimers and QTIP elections as a means of postponing the tax planning decision until the first spouse dies. Disclaimers have often been used as a means of fixing an estate plan after the death of a decedent, but they have not often been used as a planning tool.[139] In a post-EGTRRA world, however, they may well become an important planning tool because of the uncertainty surrounding the current temporary nature of the federal estate tax changes.[140] Since its creation, the federal QTIP election has also become an important estate-planning tool, and Oregon has recently allowed for a separate state QTIP election. This new state QTIP creates some interesting implications given the gap between the amount of Oregon's exemption and the federal exemption. The following section will discuss the possible uses of disclaimers and the federal and state QTIP elections in the current estate-planning environment.

A surviving spouse can use a disclaimer to refuse all or part of a bequest.[141] The disclaimed property will pass as though the surviving spouse had predeceased the decedent.[142] To avoid the gift tax, a surviving spouse's disclaimer of a property interest must first be effective under state property law.[143] Then, the disclaimer must meet four requirements under the federal tax code.[144] First, there must be an irrevocable written refusal

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[139] *Id.* at 1467.

[140] *See id*.

[141] *See* 26 U.S.C. § 2518 (1994); Shannon M. Connelly et al., *Navigating Uncertain Terrain: Ideas for Drafting in the Current Estate Tax Environment*, OR. ST. B. CLE, Nov. 19, 2004, ch. 6, at 17 (on file with author).

[142] *See* 26 U.S.C. § 2518(a) (1994); Connelly et al., *supra* note 141, at 17.

[143] *See* OR. REV. STAT. §§ 105.623-.649 (2003).

[144] Connelly et al., *supra* note 141, at 17-18; Sloan, *supra* note 122, at 1467-68.

describing the property disclaimed.[145] Second, the written disclaimer must be delivered to the executor or trustee within nine months after the decedent's death.[146] Third, the disclaimant must not have accepted the property or any of its benefits.[147] Lastly, the disclaimant cannot direct where the disclaimed property will pass.[148] Failing any of the four requirements will void the disclaimer for tax purposes. Unfortunately, the last two requirements have several complex nuances, and many disclaimers have been accidentally voided by decedents' unsuspecting kin. The "no acceptance" requirement means that the disclaimant cannot use the property; cannot accept dividends, rents, interest, or other income generated by the property; cannot act as an owner would toward the property; and cannot receive consideration in return for the disclaimer.[149] To do otherwise would be an act of acceptance.[150] The "no direction" requirement means that the disclaimant cannot direct to whom the property will pass, and any disclaimed property must pass to either the surviving spouse or to someone other than the disclaimant.[151]

A disclaimer is typically used as a planning tool by creating a scenario where the surviving spouse can disclaim all or part of a bequest under the decedent's will or trust, which then directs the disclaimed share into a credit shelter trust.[152] The surviving spouse can be an income beneficiary of the trust, but the surviving spouse cannot retain any power of appointment over the trust.[153] Estate plans can be structured to permit the use of successive disclaimers of the same property interest, allowing for several alternatives for the disposition of the property.[154] Disclaimers are complex and are not suitable for all taxpayers, but they do allow for the flexibility to wait until nine months after the decedent's death to determine the optimal disposition of the

[145] 26 U.S.C. § 2518(b)(1) (1994).
[146] *Id.* § 2518(b)(2).
[147] *Id.* § 2518(b)(3).
[148] *Id.* § 2518(b)(4).
[149] Sloan, *supra* note 122, at 1468.
[150] *Id*.
[151] *Id*. at 1469-70; *see* 26 U.S.C. § 2518(b)(4) (1994).
[152] Sloan, *supra* note 122, at 1470.
[153] *Id*. at 1471. The retention of any power of appointment over the trust will disqualify the disclaimer. 26 U.S.C. § 2518(b)(4) (1994); Connelly et al., *supra* note 141, at 18. Either the trust can be drafted without giving the surviving spouse the typical special power of appointment, or the surviving spouse can disclaim the power of appointment. *See* Sloan, *supra* note 122, at 1470-71.
[154] Sloan, *supra* note 122, at 1472.

decedent's property from the standpoints of taxation and recipient control.[155] Given the current uncertainty surrounding the permanency of the federal estate tax and the decoupling of Oregon's inheritance tax, this flexibility makes disclaimers a useful tool for planning purposes. Estate planners must take care, however, to understand to whom any disclaimed property will pass and to ensure that the recipients of property understand what is required of them to properly disclaim a bequest so that they do not inadvertently void a disclaimer.[156]

A federal QTIP election is another means of adding post-mortem flexibility to the estate-planning process. Oregon has recently provided for the use of a state QTIP election even when there is no corresponding federal election.[157] These elections can be important estate-planning tools and can create additional options for taxpayers and estate planners. As a brief bit of background, QTIP elections were created as an exception to the terminable interest property rule, which is itself an exception to the unlimited marital deduction.[158] No marital deduction is allowed for terminable interests—bequests to a surviving spouse that terminate upon the occurrence of an event (usually the spouse's death)—or if someone other than the surviving spouse receives a benefit.[159] Nevertheless, Congress created the ability to elect certain Qualified Terminable Interest Property (hence the acronym "QTIP") that will qualify for the marital deduction and receive tax deferral until the death of the surviving spouse.[160]

A federal QTIP has several requirements. The property must pass from the decedent.[161] The surviving spouse must be paid the annual income from the property for life.[162] There can be no power to appoint any portion of the property to someone other than the surviving spouse while the surviving spouse is alive.[163]

155 For an in-depth analysis of the use of disclaimers for estate planning, see *id.* at 1467-72, and Connelly et al., *supra* note 141, at 17-20.

156 Sloan, *supra* note 122, at 1472.

157 OR. ADMIN. R. 150-118.010(7)(1) (2004).

158 Sloan, *supra* note 122, at 1473. Ms. Sloan's article provides a nicely written discussion of the background and uses of QTIP elections and Clayton trusts. For a lively, well-written discussion of the history of the federal marital deduction and the QTIP election, see also Estate of Clayton v. Comm'r, 976 F.2d 1486 (5th Cir. 1992).

159 26 U.S.C. § 2056(b)(1) (1994); Sloan, *supra* note 122, at 1473.

160 Sloan, *supra* note 122, at 1473-74.

161 26 U.S.C. § 2056(b)(7)(B)(i)(I).

162 *Id.* § 2056(b)(7)(B)(i)(II), (B)(ii).

163 *Id.*

Additionally, the executor must make an irrevocable election when filing the estate tax return.[164] A partial QTIP election can also be made so that only a portion of property passing from the decedent qualifies for the marital deduction.[165] Marital trusts are usually created to take advantage of a QTIP election. When a partial QTIP election is made for a portion of the trust corpus, the remainder can still be passed in trust for the benefit of the surviving spouse, but it will be subject to estate taxes in the decedent's estate because it is terminable-interest property.[166] Thus, QTIP elections provide the flexibility for an executor to determine the appropriate size of the marital deduction as a means of optimizing the amount of federal taxes due upon the death of both spouses.[167] A key feature of QTIP elections, as well as disclaimers, is that the election is made after the decedent dies. Thus, QTIP elections allow taxpayers to take a wait-and-see approach to both their financial situations and the federal and state tax rules before they decide whether to make an election. This flexibility can be very useful in an uncertain post-EGTRRA world.

Oregon has recently provided for a separate state QTIP election that allows more flexibility. Included in HB 3072 was a statutory provision allowing the ODR to adopt rules providing for a separate state QTIP election.[168] The ODR has responded with an appropriate administrative rule that requires any Oregon QTIP election to comply with federal QTIP rules.[169] The ability to elect a separate Oregon QTIP is important because of the disjunction between the federal and state death tax exemption amounts. Prior to the creation of a separate state QTIP, Oregon taxpayers had to make a tough choice. They could fully utilize the federal exemption in a credit shelter trust and pay Oregon

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164 *Id.* § 2056(b)(7)(B)(i)(III), (B)(v).

165 Estate of Clayton v. Comm'r, 976 F.2d 1486, 1495 (5th Cir. 1992); Sloan, *supra* note 122, at 1474.

166 Sloan, *supra* note 122, at 1474-75. To meet the requirements of a QTIP election, the terms of such a trust must necessarily be written so that the trust is not includable in the surviving spouse's estate unless the QTIP election is made. *Id.* at 1475. Thus, the remaining corpus is terminable interest property.

167 *Id.* See *id.* at 1475-76 for a variety of situations where partial QTIP elections should be made.

168 Act of Sept. 24, 2003, ch. 806, § 6, 2003 Or. Laws 3399, 3400 (creating OR. REV. STAT. § 118.010(7)).

169 *See* OR. ADMIN. R. 150-118.010(7) (2004) (allowing separate elections under 26 U.S.C. § 2056 "that would have been allowed under federal law in effect as of December 31, 2000, whether or not a federal estate tax return is filed").

inheritance taxes on the amount exceeding Oregon's lower exemption.[170] Alternatively, they could fund a credit shelter trust up to the Oregon exemption amount, enabling it to pass free of both federal and state taxes, at a cost of losing the remainder of the federal exemption and paying more federal estate taxes upon the death of the second spouse.[171]

The ability to elect a state QTIP means that Oregonians can again shelter their assets in a manner that allows the tax deferral that existed prior to Oregon's decoupling from the federal estate tax system. Married couples can now fund a credit shelter trust up to the full amount of the federal exemption and elect an Oregon QTIP for the portion of the trust in excess of Oregon's exemption amount.[172] Any amount in excess of the federal exemption will qualify for the marital deduction and will be taxed by both Oregon and the federal government when the surviving spouse dies.[173] The ability for taxpayers to elect a state QTIP allows them to use the full federal exemption amount while still deferring Oregon taxes until the death of the surviving spouse, effectively "recoupling" this aspect of Oregon's inheritance tax to the federal estate tax.[174]

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170 Michael, *supra* note 50, at 1032.

171 *Id.* This assumes that the federal estate tax will exist upon the death of the second spouse. The uncertainty surrounding whether there will be a federal estate tax in the future and what the rates will be does not facilitate effective planning. Should EGTRRA's repeal of the federal estate tax become permanent, it may pay to shelter as much of the estate as possible until the second spouse dies. However, should EGTRRA's changes "sunset," then the federal tax rates may well be higher than they currently are, and deferral might actually mean that the estate of the second spouse could be taxed at a higher rate than what currently exists.

172 Jeffrey M. Cheyne, *Oregon Inheritance Tax Disconnect*, OR. ST. B. CLE, Nov. 19, 2004 ch. 2, at 9 (on file with author); Michael, *supra* note 50, at 1032. For a discussion of drafting considerations when using an Oregon QTIP election, see Connelly et al., *supra* note 141, at 6-10.

173 Connelly et al., *supra* note 141, at 7-8.

174 Cheyne, *supra* note 172, at 9-10; Michael, *supra* note 50, at 1032. Admittedly, this may be a bit of a stretch since the amount exempt from Oregon's inheritance tax is less than the amount exempt from the federal estate tax. Thus, Oregon estate taxes will now be owed on the amount sheltered by the Oregon QTIP upon the death of the second spouse. However, the Oregon QTIP allows for the deferral of state taxes until the death of the second spouse and comports with the public policy behind both the marital deduction and QTIP rules that estate taxes on a marital unit should not be paid until both spouses die. *See* Estate of Clayton v. Comm'r, 976 F.2d 1486, 1490-94 (discussing the historical background and policies behind both the marital deduction and the QTIP). The coupling of the state death tax systems onto the federal system via utilization of the state death tax credit only served to further this public policy.

Although this change is beneficial to Oregon taxpayers, the accompanying tax deferral is not necessarily good for state coffers. The tax deferral created by the Oregon QTIP causes an immediate loss of tax revenue to the state, and it may be possible for taxpayers to avoid paying Oregon taxes altogether if either the "QTIPed" assets fall below the Oregon exemption amount or if the taxpayers move out of the state.[175] Another downside to the Oregon QTIP is that the same strict federal QTIP rules must be met, which limits the flexibility of disposition and control of the QTIP assets.[176]

C. Other Estate-Planning Considerations: Cost Basis, Domicile, and Inter Vivos Gift Planning

EGTRRA and Oregon's decoupling from the federal estate tax system have created several other considerations that Oregon residents and estate-planning practitioners should take into account. The first consideration is EGTRRA's drastic change to the cost basis rules for property transferred upon death. The second consideration is the effect of the choice of taxpayer domicile on the tax-planning process. A third consideration is the effect of EGTRRA's new rules on the taxation of inter vivos gifts.

The new cost basis rules under EGTRRA have not yet been the subject of much discussion, but they will have sweeping effects for taxpayers and estate planners. EGTRRA will terminate the formerly unlimited step-up in the cost basis of property that is acquired from a decedent.[177] On January 1, 2010, the old basis rules will no longer apply, and a whole new set of rules will apply to property acquired from a decedent, which will create a new set of challenges.[178] Although these are technically income tax provisions, the new rules will affect taxpayers planning for property transfers at death and must therefore be addressed by estate planners.

Under the new federal basis rules, property acquired from a decedent will be treated as if it were acquired by gift, and the

[175] Michael, *supra* note 50, at 1032; *see also* Cheyne, *supra* note 172, at 14.

[176] Existing credit shelter trusts drafted prior to EGTRRA may not meet the QTIP requirements, for example, if the trust provides for distributions to children while the surviving spouse is alive. The example provided in the text accompanying note 125 would fail the QTIP requirements.

[177] *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 541, 115 Stat. 38 (repealing 26 U.S.C. § 1014).

[178] *See id*. §§ 541-42.

basis of such property will be the lesser of the decedent's adjusted basis or the property's fair market value on the date of death.[179] However, the new rules allow a $1.3 million step-up in the basis of property transferred to nonspouses and a $3 million step-up in the basis of property transferred to spouses.[180] Because these exemptions relate to the cost basis of the property transferred rather than the value of the property, taxpayers and estate planners will be required to look at the property in a new light when making planning decisions.[181] Property *appreciation*, not value, will be the critical consideration in determining how much of the available $4.3 million of exemptions can be used and how such property should be transferred upon death. Because these exemptions are specific to each taxpayer and are lost at death, one author has suggested using a "step-up trust" to capture the full value of these exemptions in a manner similar to how credit shelter trusts are used to fully capture the federal estate tax exemption.[182]

By allocating highly appreciated assets to a step-up trust, a married couple could fully use each spouse's $1.3 million exemption (plus the additional $3 million exemption for spouses) rather than lose the nonspouse exemption upon the death of the first spouse.[183] If the property is transferred outright to the surviving spouse rather than via a step-up trust, the allowable $1.3 million exemption would be lost.[184] Thus, these trusts may become a popular means of sheltering highly appreciated assets of wealthy taxpayers once the new basis rules take effect.[185]

There are several potential administrative complications cre-

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[179] 26 U.S.C.A. § 1022(a)-(b) (West 2002).

[180] *Id.* § 1022(b)(2)(B), (c)(2)(B). These amounts are indexed for inflation starting in 2011. *Id.* § 1022(d)(4).

[181] Sloan, *supra* note 122, at 1459.

[182] Pareja, *supra* note 2, at 75. The new basis rules seem to be the forgotten stepchild of EGTRRA's changes. These changes appear to have received much less attention from academics and practitioners than the estate and gift tax changes, possibly because they are not scheduled to take effect for another several years. Mr. Pareja's article is the most thorough on the topic that this author's research has found to date. It provides great insight into the complexities and administrative difficulties of both the new basis rules and the use of such step-up trusts to fully capture the basis exemptions.

[183] *Id.* at 84.

[184] *Id*.

[185] *Id.* at 75. The interesting thing to note regarding the use of basis exemptions is how it will affect taxpayers differently. Wealthy taxpayers with high-basis assets might not be able to fully use the exemptions if they don't own assets that have appreciated by at least $4.3 million.

ated by the new basis rules. First, the new basis rules will obviously require thorough recordkeeping regarding the basis of all taxpayer assets. This could become a potential pitfall for unsuspecting beneficiaries. Currently, the step-up in the basis of all assets transferred by the decedent upon death has the effect of forgiving the decedent's lousy recordkeeping. In the future, computing the basis of assets in excess of the exemption amounts could become a nightmare for the transferee if records were lost or poorly kept. Second, taxpayers who are planning to create a step-up trust will also have administrative costs similar to the costs surrounding a credit shelter trust in addition to the complications of determining what property should be used to fund the step-up trust.[186]

Another interesting nuance of the basis rules is that property passing to a surviving spouse via a QTIP trust will receive a stepped-up basis, while property being transferred from a QTIP trust upon the surviving spouse's death will not.[187] This is an additional complication, as the surviving spouse must have enough assets outside the QTIP trust to take advantage of his or her own allowable basis exemption.[188] Although Oregon does not appear to have added any further complications,[189] the complications at the federal level created by EGTRRA will add to the administrative costs and planning concerns for both taxpayers and estate-planning practitioners.

A second consideration for Oregon taxpayers and estate-planning practitioners relates to the potential for domicile planning under the EGTRRA framework. Because states have responded to EGTRRA in different ways, the choice of domicile has again become a relevant concern for Oregon taxpayers.[190] Depending on the state death tax system and the type of property taxed at

[186] *See id.* at 83-84.

[187] Sloan, *supra* note 122, at 1460; *see also* 26 U.S.C.A. § 1022(c)(3)(b), (e) (West 2002).

[188] Sloan, *supra* note 122, at 1460.

[189] Oregon law regarding the basis of property for income tax purposes remains tied to federal law. *See* OR. REV. STAT. § 316.007 (2003). Thus, estate plans designed to take advantage of the changes to federal law should necessarily be optimal for Oregon income tax purposes.

[190] Taxpayer and beneficiary domicile was often a relevant consideration when Oregon's inheritance tax was based on the relationship of the beneficiary to the decedent. Telephone Interview with Charles J. McMurchie, of Counsel, Stoel Rives LLP (Feb. 17, 2005). When Oregon started using a pure pick-up tax, taxpayer domicile became less of a concern because taxes were standardized around the federal credit. *Id.*

the state level, taxpayers may have an incentive to move from a decoupled state to a true pick-up state where the state death taxes will likely be lower. Although residents of a pick-up state will no longer be subject to that state's death tax after 2005 because of the elimination of the state death tax credit, the actual effect on any state taxes due will likely depend on the situs of the taxpayer's property.

States often treat real property and personal property differently based on whether a decedent is a resident or nonresident of the state. For example, Nevada is one of the pick-up states with a constitutional restriction against imposing a death tax that is not tied to the federal state death tax credit.[191] For resident decedents, Nevada imposes a tax on real and tangible personal property with a Nevada situs, and intangible personal property subject to the state's jurisdiction is taxed regardless of where it is located.[192] For nonresident decedents, Nevada imposes a tax on real and tangible personal property with a Nevada situs, but intangible personal property is not taxed unless the decedent is a non-U.S. resident.[193]

Oregon's inheritance tax on resident decedents is similar to Nevada's because it is imposed on all real and tangible personal property in Oregon and all intangible property regardless of its location.[194] However, Oregon only imposes a tax on all real and personal property located in Oregon owned by nonresident decedents.[195] Thus, Oregon and Nevada differ on the taxation of intangible personal property.[196] Such differences are subtle, but they may be important.

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[191] *See supra* note 53.

[192] NEV. REV. STAT. § 375A.100(1) (2004).

[193] *Id.* § 375A.100(2).

[194] *See* OR. REV. STAT. § 118.010(3) (2003).

[195] *See id.* § 118.010(4)(a).

[196] Oregon will not tax intangible personal property of a nonresident decedent if the decedent's state of residency does not tax intangible personal property of nonresident decedents. *Id.* § 118.010(4)(b). Thus, on the surface, Nevada and Oregon effectively tax real and personal property in a similar manner. However, Oregon's administrative rules state that "[t]here is no such exemption allowed as to property owned by a deceased resident of a state which does not impose a death tax." OR. ADMIN. R. 150-118.010(4)(b) (2004). Thus, once Nevada's pick-up tax is effectively repealed due to the repeal of the underlying federal credit in 2005, Nevada will effectively impose no state death tax even though its statute remains in place. Although Oregon's administrative rules do not address this scenario, a strong argument could be made that the reciprocal exemption for intangible personal property in section 118.010(4)(b) does not apply.

For example, an Oregon couple owning real property in both Nevada and Oregon will be taxed on the real property (and all personal property) in Oregon, but they will not be taxed on the real property in Nevada.[197] Should this couple decide to change their domicile and move to Nevada, they would only be taxed on the real property, tangible personal property, and the intangible personal property remaining in Oregon. If their domicile planning is done properly, the couple will take most of their tangible personal property and all of their intangible personal property to Nevada when they move.[198] The couple would thereby be taxed only on the real property and remaining tangible personal property left in Oregon, which should significantly reduce their state death tax burden.

Another option for taxpayers in this situation would be to change the character of the real property remaining in Oregon into intangible personal property so that its situs will follow the taxpayer to the new state of domicile. By contributing real property to a limited liability corporation or a limited partnership, the character of the real property interest will be changed into intangible personal property.[199] Thus, even taxation on the real property in Oregon may be eliminated if it is held through such an out-of-state entity. Due to EGTRRA's effects on the states, then, taxpayers and estate planners should be cognizant of the differences in state taxation when planning where the taxpayers should retire and in what form their assets should be held.

A final consideration for Oregon taxpayers and estate-planning practitioners should be EGTRRA's new rules for the taxation of inter vivos gifts. Prior to EGTRRA, the estate and gift taxes were linked via a single combined lifetime exclusion for transfers.[200] EGTRRA detached the federal estate and gift taxes

[197] This example assumes that there is no Nevada death tax levied after the repeal of the state death tax credit in 2005.

[198] Intangible personal property should be relatively easy to move to a new domicile because it includes "stocks, bonds, notes, currency, bank deposits, accounts receivable, patents, trademarks, copyrights, royalties, goodwill, partnership interests, [and] life insurance policies." *Id.* at 150-118.010(1)-(2)(c)(3). Thus, such property that is not considered to have left the state once the owner changes domicile could be moved out of Oregon physically by changing the location of the account or by selling the ownership interests in Oregon corporations and using the proceeds to purchase non-Oregon assets. *See id.* at 150-118.010(1).

[199] *See* Davidowitz, *supra* note 25, at 424.

[200] *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(a)-(b), 115 Stat. 38 (amending 26 U.S.C. §§ 2001, 2505 (2000)); Davidowitz, *supra* note 25, at 410-11; Sloan, *supra* note 122, at 1453-54.

such that the federal gift tax now has a lower exclusion amount than the estate tax and the gift tax remains in existence after the estate tax is repealed.[201] Pre-EGTRRA gift tax planning typically involved using the $11,000 annual exclusion[202] and the exclusions for educational and medical expenses[203] because these exclusions did not count against the $1 million lifetime exclusion.[204] Because the federal gift and estate tax exclusions were linked, no additional gift tax planning was required because planning that fully utilized the exclusion for estate tax purposes would necessarily encompass the gift tax as well. The only other relevant planning consideration involved addressing the effects of any state gift tax.

With EGTRRA's changes, however, gift tax planning has become more complex. The gift tax exclusion is now $1 million while the estate tax exclusion is $1.5 million as of 2005 and incrementally increases to $3.5 million in 2009.[205] Thus, prior to the estate tax repeal in 2010, taxpayers will have a lower overall tax burden if they keep their total inter vivos transfers to less than $1 million and wait until death to make transfers of larger amounts. Doing so would make the most of the higher exemption for the estate tax while allowing taxpayers to avoid any gift tax. If total inter vivos gifts of greater than $1 million are made, a taxpayer would end up paying an unnecessary gift tax on the excess transfers. Should EGTRRA's changes become permanent, then as of 2010, a taxpayer should avoid making any inter vivos gifts of greater than $1 million because the entire estate should pass free of any federal transfer tax. Because the new basis rules also take effect in 2010, any such inter vivos gifts should be of high-basis assets, if possible, so that the taxpayer can fully use the $4.3 million basis step-up for highly appreciated assets transferred upon

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201 *See* Economic Growth and Tax Relief Reconciliation Act of 2001 §§ 501, 511(d), 521(b)(2); Davidowitz, *supra* note 25, at 410-11; Sloan, *supra* note 122, at 1453-54.

202 *See* 26 U.S.C. § 2503(b)(1) (Supp. III 1997). The base exclusion of $10,000 is indexed for inflation. *Id.* § 2503(b)(2). For tax years 2002-2005, the exclusion is $11,000. INTERNAL REVENUE SERV., DEP'T OF TREASURY, ESTATE AND GIFT TAXES, *at* http://www.irs.gov/businesses/small/article/0,,id=98968,00.html (last visited June 29, 2005); INTERNAL REVENUE SERV., DEP'T OF TREASURY, GIFT TAX QUESTIONS, *at* http://www.irs.gov/businesses/small/article/0,,id=108139,00.html (last visited June 29, 2005).

203 *See* 26 U.S.C. § 2503(e) (1994).

204 *See* 26 U.S.C. § 2503(b), (e) (1994 & Supp. III 1997).

205 *See* Economic Growth and Tax Relief Reconciliation Act of 2001 § 521(a)-(b).

death.[206]

At the state level, Oregon no longer imposes a gift tax, but this actually complicates tax planning somewhat because assets given away during life are not included in the decedent's adjusted taxable estate upon death.[207] Since the adjusted taxable estate is used to compute the amount of the state death tax credit by which Oregon's inheritance tax is levied, inter vivos transfers avoid the state inheritance tax due on such assets and potentially drop the estate into a lower state estate tax bracket.[208] Thus, in addition to utilizing the medical, educational, and $11,000 individual exclusions, Oregon taxpayers should also take into consideration the ability to use the disjunction between the federal estate and gift tax exclusions and the lack of an Oregon gift tax when planning inter vivos transfers.

VII

THE FUTURE: AN ANALYSIS OF INHERITANCE TAX LEGISLATION PROPOSED DURING OREGON'S 2005 LEGISLATIVE SESSION

Barring any constitutional questions,[209] the future of the Ore-

[206] Of course, if the taxpayer has assets with more than $4.3 million of total appreciation, then the inter vivos transfers should likely be made with depreciated assets as a means of minimizing the potential taxes of the donee under the basis rules for gifts. *See* 26 U.S.C. § 1015(a) (1994); Connelly et al., *supra* note 141, at 11.

[207] *See* Connelly et al., *supra* note 141, at 10.

[208] *See* 26 U.S.C. § 2011(b) (Supp. III 1997); Connelly et al., *supra* note 141, at 10.

[209] Although not necessarily relevant to Oregon law, a recent Washington Supreme Court decision invalidating that state's current estate tax as being unconstitutional bears mention because of some similarities to Oregon's inheritance tax. *See* Estate of Hemphill v. State, No. 74974-4, 2005 Wash. LEXIS 89, at *13 (Wash. Feb. 3, 2005). Washington's estate tax is structured similarly to Oregon's inheritance tax in that it is a pick-up tax based on the amount of the state death tax credit as of a specific date. *See* WASH. REV. CODE ANN. §§ 83.100.020(15), 83.100.030 (West 2000 & Supp. 2005). Similar to Oregon's tie-in date, the Washington estate tax was tied to pre-EGTRRA federal law as of January 1, 2001 WASH. REV. CODE ANN. § 83.100.020(15) (West 2000). The court held that an estate tax exceeding the amount of the *current* state death tax credit was an unconstitutional independent tax because it conflicted with the purpose of a 1981 voter initiative that expressly restricted any tax to the amount of the credit. *See Hemphill*, 2005 Wash. LEXIS 89, at *4-5, 10-11. The court also found that the legislature had not since changed the nature of the tax system to allow for an inheritance tax independent of the federal credit. *Id.* at *11-12. While *Hemphill* may become the subject of much future discussion in Washington, it likely has little relevance to Oregon. Although both states' death tax systems are statutorily similar, their background constitutional law is quite different. Oregon's constitution allows its statutes to reference federal law as it existed on a prior date. Seale v. McKennon, 215 Or. 562, 572, 336 P.2d 340, 345 (1959).

gon inheritance tax is in the hands of the Oregon legislature. During the 2005 legislative session, the Oregon legislature considered several bills that would have impacted Oregon's inheritance tax in a variety of ways.[210] Although only one of these bills was enacted, it is worth discussing all the bills and their proposed changes to Oregon's inheritance tax system because such proposals are likely to come before the legislature again for consideration in the future.

Several of these bills were similar in nature, and their proposed changes to Oregon's inheritance tax system can be separated into four broad categories. The first set of bills would have repealed Oregon's inheritance tax entirely.[211] The second set of bills would have amended Oregon's inheritance tax so that Oregon's exemption would match the increasing federal exemption under EGTRRA.[212] The third set of bills would have adopted the federal exemptions under EGTRRA and created a stand-alone Oregon inheritance tax that is no longer based on the state death tax credit.[213] Finally, the purpose of the fourth set of bills was to create a new statute allowing certain property to be designated as "Oregon Special Marital Property" upon the death of the first spouse.[214] The proposals within all four categories of

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Unlike Washington, Oregon does not appear to have specifically restricted an inheritance tax to be solely equal to the amount of any current federal credit. Thus, the apparent similarities in circumstance are superficial, and an argument similar to that employed in *Hemphill* would likely fail in Oregon.

In a final note on *Hemphill*, the Washington legislature has since taken the *Hemphill* court's advice and enacted a stand-alone estate tax, effective May 17, 2005. *See* WASH. STATE DEP'T OF REVENUE, SPECIAL NOTICE: NEW WASHINGTON ESTATE TAX 1 (May 17, 2005), *available at* http://dor.wa.gov/Docs/Pubs/SpecialNotices/2005/sn_05_NewEstateTaxLaw.pdf (last visited Sept. 6, 2005).

210 When Oregon's legislature adjourned on August 5, 2005, research by the author revealed that the legislature had considered nine bills that would have materially altered Oregon's inheritance tax: S.B. 382, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), S.B. 438, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), H.R.B. 2469, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (enacted June 6, 2005), H.R.B. 2293, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), H.R.B. 3234, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), H.R.B. 3357, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), H.R.B. 3421, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), H.R.B. 2629, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), and H.R.B. 3402, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted).

211 *See* S.B. 438; H.R.B. 3234; H.R.B. 3357.

212 *See* S.B. 382; H.R.B. 3402.

213 *See* H.R.B. 2629; H.R.B. 3421.

214 *See* H.R.B. 2293; H.R.B. 2469. House Bill 2469 was enacted June 6, 2005 to

bills would have interesting implications for Oregon's inheritance tax system.

The first set of bills considered but not enacted by the legislature included Senate Bill 438 (SB 438), House Bill 3234 (HB 3234), and House Bill 3357 (HB 3357). These bills would have completely eliminated Oregon's inheritance tax, and Oregon would have been prohibited from collecting any inheritance taxes levied on the estates of decedents dying in or after 2006.[215] Inheritance taxes could still have been collected from the estates of decedents dying prior to 2006.[216] Then, when the federal estate tax is scheduled for repeal in 2010, these bills would have officially repealed Oregon's inheritance tax statutes.[217] These bills would also have removed all references to Oregon's inheritance tax throughout the rest of the Oregon Revised Statutes.[218]

The ramifications of such changes would have been great. First, Oregon would have seen a complete loss of inheritance tax revenue starting in 2006. This loss would likely have a damaging effect on Oregon's fiscal health because it would cost the state an estimated $100 million in lost revenue in the first biennium after the enactment.[219] However, inheritance tax repeal would have markedly simplified tax planning for Oregonians because there would no longer be a need to plan for state inheritance taxes. For now, the Oregon legislature appears to have decided that the benefits to the few Oregonians wealthy enough to gain from an estate tax repeal were outweighed by the costs to the general citizenry of such repeal. Given the failure of these and other recent attempts to repeal Oregon's inheritance tax,[220] as well as the ongoing state budget problems, it is unlikely that any such inheritance tax repeal will become law unless revenue can be found from other sources to make up for the likely shortfall that would be created.

become 2005 Or. Laws ch. 124. *See* Oregon Legislative Assembly, 2005 Regular Session Measures, House Measure History, *at* http://www.leg.state.or.us/bills_laws/.

[215] S.B. 438 § 1; H.R.B. 3234 § 1; H.R.B. 3357 § 1.

[216] *See* S.B. 438 § 3; H.R.B. 3234 § 3; H.R.B. 3357 § 3.

[217] *See* S.B. 438 § 2; H.R.B. 3234 § 2; H.R.B. 3357 § 2.

[218] S.B. 438 §§ 4-19; H.R.B. 3234 §§ 4-19; H.R.B. 3357 §§ 4-19.

[219] This is an approximation by the author based on data and recent trends in the collection of Oregon's inheritance tax revenues as found in the current report of the Legislative Revenue Office. *See* BASIC FACTS, *supra* note 87, at F3. The author could find no official estimate of the expected fiscal impact of Senate Bill 438, House Bill 3234, or House Bill 3357.

[220] *See supra* notes 98-99 and accompanying text.

The second category of bills considered but not enacted by Oregon's legislature included Senate Bill 382 (SB 382) and House Bill 3402 (HB 3402). Both bills were large tax measures with similar purposes and provisions; thus, apparently they were separate Senate and House versions of the same proposal.[221] Within these bills were several provisions that would have increased Oregon's inheritance tax exemption such that an inheritance tax return would not have to be filed and no tax would be due if the decedent's taxable estate is $1.5 million or less in 2005, $2 million or less in 2006–2008, and $3.5 million or less in 2009.[222] These proposed changes were identical to EGTRRA's current schedule of increases in the federal exemption.[223] Thus, it appears these bills were an attempt to partially recouple Oregon's inheritance tax to federal law. However, unlike the first set of bills, neither SB 382 or HB 3402 appears to have been an attempt to repeal Oregon's inheritance tax; thus, these changes would have remained in effect both during the scheduled federal estate tax repeal in 2010 and after the federal law resets back to pre-EGTRRA law in 2011.[224]

The enactment of these proposed changes would have had several implications. First, Oregon would likely have seen a marked loss in inheritance tax revenue as the exemption amount increased because fewer estates would be required to pay inheritance taxes and fewer assets would be taxed. Second, reconnecting Oregon's exemption to the federal exemption amount would have helped simplify tax planning for Oregonians because there would no longer be a need to plan around the current difference between these exemption amounts.

Nevertheless, these proposals would not have necessarily alleviated any of the current uncertainty surrounding estate tax planning. Although both bills would have recoupled Oregon's exemption to the federal exemption through 2009, much tax planning would still depend on what Congress decides to do about EGTRRA's sunset provisions. If Congress allows EGTRRA to sunset, the federal exemption would drop back to the $1 million level in 2011 under TRA97. This would create the antithesis of the current problem, because the federal exemption would

221 *See* S.B. 382; H.R.B. 3402.

222 S.B. 382 § 7; H.R.B. 3402 § 7.

223 *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(a), 115 Stat. 38 (amending 26 U.S.C. § 2010(c) (2000)).

224 *See* S.B. 382; H.R.B. 3402.

be less than the $3.5 million Oregon exemption in 2011 as proposed under either SB 382 or HB 3402. Congress could also make EGTRRA's changes permanent or decide to keep the estate tax in force but enact an entirely new set of changes. Because there will be uncertainty until Congress acts, Oregonians will have a hard time planning how to structure their estate plans from a taxation standpoint. Thus, although either of these bills would have provided some certainty with regard to Oregon's inheritance tax, they would have done nothing to alleviate the problems created by the uncertainty in the federal system.

The third category of bills considered but not enacted by the 2005 Oregon legislature included House Bill 2629 (HB 2629) and House Bill 3421 (HB 3421). Both bills would have implemented many changes to Oregon's inheritance tax system, including coupling Oregon law to EGTRRA and creating a separate standalone Oregon tax that would no longer be based on the federal death tax credit.[225] A quick analysis of the text of HB 2629[226] reveals a proposal with several distinct changes to Oregon's current system. First, HB 2629 would have tied Oregon's inheri-

[225] *See* H.R.B. 2629 §§ 2-3; H.R.B. 3421 §§ 2-3.

[226] Both House Bill 2629 and House Bill 3421 had similar text and purposes with a few differences. This Comment will discuss House Bill 2629's proposed changes and note the key differences between the two bills. The relevant portions of House Bill 2629 read:

> SECTION 2. ORS 118.007 is amended to read:
>
> 118.007. Any term used in ORS 118.005 to 118.840 has the same meaning as when used in a comparable context in the laws of the federal Internal Revenue Code relating to federal estate taxes, unless a different meaning is clearly required or the term is specifically defined in ORS 118.005 to 118.840. Any reference in ORS 118.005 to 118.840 to the Internal Revenue Code means the federal Internal Revenue Code as amended and in effect on December 31, 2004, except where the Legislative Assembly has specifically provided otherwise.
>
> SECTION 3. ORS 118.010 is amended to read:
>
> 118.010. (1) A tax is imposed upon the taxable estate of a decedent that is within the jurisdiction of the state, as provided for in this section.
>
> (2) The tax imposed under this section for decedents who die on or after January 1, 2007, and before January 1, 2009, shall be determined in accordance with the following table:

tance tax to federal laws existing as of December 31, 2004.[227] Second, beginning in 2007, HB 2629 would have created a stand-

If Taxable Estate		The Amount Of Tax Equal		Of Estate Value
Is At Least	But Less Than	Initial Tax Amt	Plus Tax Rate %	Greater than
$ 0	2,000,000	$ 0	0.0%	$ -
2,000,000	2,100,000	$ 0	4.00%	2,000,000
2,100,000	2,200,000	$ 4,000	4.00%	2,100,000
2,200,000	2,300,000	$ 8,000	4.00%	2,200,000
2,300,000	2,400,000	$ 12,000	8.00%	2,300,000
2,400,000	2,500,000	$ 20,000	8.00%	2,400,000
2,500,000	2,600,000	$ 28,000	8.00%	2,500,000
2,600,000	2,700,000	$ 36,000	12.00%	2,600,000
2,700,000	2,800,000	$ 48,000	12.00%	2,700,000
2,800,000	2,900,000	$ 60,000	12.00%	2,800,000
2,900,000	3,000,000	$ 72,000	16.00%	2,900,000
3,000,000	3,250,000	$ 88,000	16.00%	3,000,000
3,250,000	3,500,000	$ 128,000	16.00%	3,250,000
3,500,000	3,750,000	$ 168,000	16.00%	3,500,000
3,750,000	4,000,000	$ 208,000	16.00%	3,750,000
4,000,000	4,500,000	$ 248,000	16.00%	4,000,000
4,500,000	5,000,000	$ 328,000	16.00%	4,500,000
5,000,000	6,000,000	$ 408,000	16.00%	5,000,000
6,000,000	7,000,000	$ 568,000	16.00%	6,000,000
7,000,000	8,000,000	$ 728,000	16.00%	7,000,000
8,000,000	9,000,000	$ 888,000	16.00%	8,000,000
9,000,000	10,000,000	$1,048,000	16.00%	9,000,000
Above $10,000,000		$1,208,000	16.00%	Above $ 10,000,000

(3) The tax imposed under this section for decedents who die on or after January 1, 2009, shall equal 16 percent of the taxable estate that exceeds $3.5 million.

. . . .

SECTION 6. ORS 118.160 is amended to read:

118.160. (1) Except as provided in subsection (2) of this section:

(a) An inheritance tax return is not required with respect to the estates of decedents dying on or after January 1, 1987, and before January 1, 2003, unless a federal estate tax return is required to be filed; and

(b) An inheritance tax return is not required with respect to the estates of decedents dying on or after:

(A) January 1, 2003, and before January 1, 2004, unless the value of the gross estate is $ 700,000 or more;

(B) January 1, 2004, and before January 1, 2005, unless the value of the gross estate is $ 850,000 or more;

(C) January 1, 2005, and before January 1, 2006, unless the value of the gross estate is $ 950,000 or more;

(D) January 1, 2006, and before January 1, 2007, unless the value of the gross estate is $ 1 million or more;

(E) January 1, 2007, and before January 1, 2009, unless the value of the gross estate is $ 2 million or more; or

(F) January 1, 2009, unless the value of the gross estate is $ 3.5 million or more.

. . . .

SECTION 7. The amendments to ORS 118.005, 118.007, 118.010, 118.100, 118.120 and 118.160 by sections 1 to 6 of this 2005 Act apply to estates of decedents who die on or after January 1, 2007.

[227] H.B. 2629 § 2.

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alone inheritance tax with progressive marginal rates up to 16% for taxable estates over $10 million.[228] In 2009, this proposed tax would have become a flat 16% on estates over $3.5 million.[229] HB 2629's third major change would have been to delete Oregon's current statutory language that allows for separate Oregon QTIP elections.[230] The final major change of HB 2629 would have been to tie Oregon's inheritance tax exemption amount to the current scheduled increases in the federal exemption under EGTRRA.[231]

These changes would have had several important ramifications. First, by changing the tie-in date to federal law, HB 2629 would have recoupled Oregon's inheritance tax to current federal law under EGTRRA. Second, increasing the Oregon exemption amount to match the federal exemptions under EGTRRA would also have created effects similar to SB 382 or HB 3402.[232] HB 2629's proposed deletion of Oregon's statutory language allowing for a separate state QTIP election is a bit curious. Although a separate election would likely not be needed as long as Oregon were to remain tied to federal law, the suspect permanency of the federal estate tax changes could cause problems for Oregonians. The proposed deletion of this estate-planning tool will likely mean that estate plans drafted with a separate Oregon QTIP may need to be amended. Also, should the Oregon legislature ever fail to keep Oregon's inheritance tax coupled to the federal exemption levels, a separate QTIP election would again become a useful tax planning tool. At most, allowing a separate Oregon QTIP to exist would simply create a bit of redundancy within Oregon's tax code. By removing this language, however, HB 2629 would likely have created problems for Oregon taxpayers and estate planners in the future.

The final ramification of HB 2629 would have been the creation of a phased-in, stand-alone Oregon inheritance tax. Beginning in 2007, a progressive schedule of rates would have applied

228 *See id*. § 3. Such a proposal would create Oregon's first stand-alone inheritance tax since moving to a pure pick-up tax in 1987. *See supra* notes 82-85 and accompanying text. House Bill 3421 differs from House Bill 2629 in that the former would have apparently enacted a stand-alone tax that is a flat percentage of the taxable estate as of January 2006. *See* H.R.B. 3421 §§ 3(1)-(2), 7.

229 H.R.B. 2629 § 3.

230 *Id*.

231 *See id*. § 6.

232 *See supra* pp. 355-56 for discussion of the effects of these two bills.

to Oregon estates, with rates ranging from 4% on amounts above $2 million to 16% on amounts above $10 million.[233] These rates would have corresponded somewhat with the current range of rates under the state death credit. However, HB 2629's table of rates was structured more simply and its changes would have occurred at different threshold amounts.[234] When the current Oregon exemption increases to $3.5 million in 2009, HB 2629 would have imposed a flat 16% tax on estates over $3.5 million.[235] This last change has interesting implications. Once HB 2629's changes would have been fully implemented in 2009, Oregon would only have taxed estates in excess of $3.5 million, and HB 2629's 16% marginal rate would have been higher than Oregon's current 9.6% marginal rate at the same threshold.[236] As noted previously, HB 2629's higher exemption amounts would have naturally reduced Oregon's inheritance tax collections, but HB 2629's higher marginal tax rate on taxable estates between $3.5 million and $10 million would have helped to offset the revenue loss of the increased exemption. Basically, under HB 2629, smaller estates would have become fully exempt while somewhat larger estates would have likely paid more. This is an interesting idea. Such a change might potentially benefit more taxpayers at the expense of a few, and the actual revenue impact to the state might be relatively neutral. As Oregon's legislature continues to grapple with various inheritance tax proposals in future years, it should keep this idea in mind.

Overall, the proposals within HB 2629 and HB 3421[237] would have created a separate, simple state inheritance tax, and either

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[233] H.R.B. 2629 § 3(2).

[234] *Compare id.*, *with* 26 U.S.C. § 2011(b) (1994), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 531, 115 Stat. 38.

[235] H.R.B. 2629 §§ 3(3), 6(1).

[236] Under current Oregon law, taxable estates from $3.5 million to $3.54 million are taxed at a rate of 9.6%. *See* OR. REV. STAT. § 118.010(2) (2003); 26 U.S.C. § 2011(b) (1994), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001 § 531. Oregon currently does not impose a 16% marginal tax rate until a taxable estate exceeds $10.04 million. 26 U.S.C. § 2011(b) (1994), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001 § 531.

[237] As discussed in notes 227-29, *supra*, House Bill 3421 was drafted with similar provisions to House Bill 2629, but it used a flat marginal tax rate rather than a table of increasing rates like House Bill 2629. Thus, it would have created effects similar to House Bill 2629. The proposed marginal tax rate had yet to be fixed within the text of House Bill 3421. *See* H.R.B. 3421 § 3. However, under House Bill 3421, a revenue-shifting effect similar to that discussed for House Bill 2629 could still be created by a combination of House Bill 3421's higher-than-current exemptions and a higher-than-current tax rate.

bill would have simplified tax planning by recoupling Oregon to current federal law. Because of the offsetting changes in the marginal tax rates and exemptions, it is also likely that neither bill would have posed serious revenue problems for the state. Still, these bills also had the same inherent problems as SB 382 and HB 3402 due to the uncertainty surrounding current federal law. Also, the deletion of the separate Oregon QTIP, while seemingly appropriate given the proposed changes, may also have caused more problems down the road if Oregon were to again become decoupled from the federal system.

The fourth type of inheritance tax bill that came before the 2005 Oregon legislature was the most interesting because of the unique means utilized to solve several current estate-planning problems. House Bill 2469 (HB 2469) was a well-drafted bill signed into law on June 5, 2005, and it should allow Oregon's married couples[238] greater flexibility in their current and future estate plans.[239] HB 2469 allows for an executor to designate cer-

[238] House Bill 2469 specifically references "spouse" throughout its provisions, so its unique benefits will not be available to unmarried couples.

[239] There were actually two bills with identical texts considered by the Oregon legislature: House Bill 2469 and H.R.B. 2293, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted). While the texts and purposes of both bills are identical, House Bill 2293 was introduced first with a broader "relating to" clause in the synopsis of the bill. *Compare* H.R.B. 2293, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (not enacted), *with* H.R.B. 2469, 73d Legis. Assemb., Reg. Sess. (Or. 2005) (enacted June 6, 2005). The Oregon House was concerned that the broad "relating to" clause of House Bill 2293 would have allowed the Senate to tack on other provisions to the bill, so House Bill 2293 was replaced by House Bill 2469. E-mail from Karey Schoenfeld, Chair, Oregon State Bar Tax Section, to Steven D. Nofziger, student, University of Oregon School of Law (Feb. 7, 2005, 7:44 AM PST) (on file with author). Given these circumstances, it is quite likely that many of the other bills with similar texts previously discussed are facing similar circumstances, such that only one of a particular type of bills is slated to move forward. House Bill 2469 was enacted June 6, 2005 to become 2005 Or. Laws ch. 124. *See* Oregon Legislative Assembly, 2005 Regular Session Measures, House Measure History, *at* http://www.leg.state.or.us/bills_laws/.

The relevant portions of House Bill 2469 read:

> SECTION 2. (1) For purposes of computing the tax imposed under ORS 118.010, the taxable estate to be used for computing the maximum amount of the state death tax credit allowable under section 2011 of the Internal Revenue Code shall be the taxable estate determined for federal estate tax purposes, reduced by the value on the date of death of the decedent of all Oregon special marital property in the estate.
>
> (2) Oregon special marital property consists of any trust or other property interest, or a portion of a trust or property interest:
>
> (a) In which principal or income may be accumulated or distributed to or for the benefit of only the surviving spouse of the decedent during the lifetime of the surviving spouse;

tain property in a decedent's estate as "Oregon Special Marital

(b) In which a person may not transfer or exercise a power to appoint any part of the trust or other property interest to a person other than the surviving spouse during the lifetime of the surviving spouse; and

(c) For which the executor of the estate of the decedent has made the election described in section 3 (1) of this 2005 Act.

(3) If a trust or other property interest would qualify as Oregon special marital property under subsection (2) of this section except that the trust or other property interest allows principal or income to be distributed to other persons in addition to the surviving spouse, the executor may elect to set aside a share of the trust or other property interest as a separate share of the trust or property interest or as a separate trust, which shall qualify as Oregon special marital property if:

(a) The executor makes the election described in section 3 (1) of this 2005 Act;

(b) Each beneficiary who is living at the time the election is made and who may be entitled to a distribution from the share during the lifetime of the surviving spouse makes the election described in section 3 (2) of this 2005 Act;

(c) The surviving spouse makes the election described in section 3 (2) of this 2005 Act; and

(d) All elections are attached to the inheritance tax return filed with respect to the estate of the decedent, or are filed or maintained as records as otherwise prescribed by the Department of Revenue by rule.

SECTION 3. (1) The executor of an estate containing property that the executor seeks to qualify as Oregon special marital property under section 2 of this 2005 Act shall make an election under this subsection in order for the property to be Oregon special marital property. The election shall be made:

(a) By attaching a statement to the inheritance tax return for the estate of the decedent that identifies the trust or other property interest that constitutes Oregon special marital property and that affirms that the identified property meets the requirements of Oregon special marital property under section 2 of this 2005 Act and will be administered as required under section 2 of this 2005 Act; or

(b) In such other manner as the Department of Revenue prescribes by rule.

(2) For a trust or other property interest described in section 2 (3) of this 2005 Act, in order for any portion of the trust or other property interest to be Oregon special marital property, in addition to the election of the executor described in subsection (1) of this section, the surviving spouse and each beneficiary who is living at the time of the election and who may be eligible for a distribution from the trust or other property interest during the lifetime of the surviving spouse shall make an election and written consent. . . .

. . . .

(3) Elections made under this section are irrevocable.

(4) The custodial parent or court appointed guardian of a minor beneficiary may sign the election on behalf of the minor beneficiary and the unborn lineal descendents of the minor beneficiary.

SECTION 4. For purposes of computing the tax imposed under ORS 118.010, the gross estate of a decedent who was a surviving spouse with respect to property that is Oregon special marital property under section 2

Property."[240] Three specific requirements are imposed on such property. First, principal and income interests may only be used for the benefit of the surviving spouse while that spouse is alive.[241] Second, a power to appoint property to anyone other than the surviving spouse while that spouse is alive cannot exist.[242] Finally, the executor must make an election to designate the property as Oregon Special Marital Property.[243] The result is that Oregon Special Marital Property is not included in the decedent's taxable estate, but it is included in the surviving spouse's taxable estate.[244]

If these requirements appear somewhat similar to those of a QTIP election, it is because one of HB 2469's stated purposes is to "broaden[ ] the definition of an Oregon 'QTIP' election to include a credit shelter trust with discretionary income distributions to the surviving spouse."[245] Other stated purposes of HB 2469 include addressing the malpractice concerns of Oregon es-

of this 2005 Act shall include the Oregon special marital property, valued as of the date of death of the surviving spouse.

SECTION 5. (1) An Oregon inheritance tax return that is filed with respect to a death occurring on or after January 1, 2002, and before the effective date of this 2005 Act, may be amended to make the elections described in sections 2 and 3 of this 2005 Act on or before the later of:

(a) December 31, 2006; or

(b) The deadline otherwise prescribed by law for the filing of an amended inheritance tax return.

(2) An inheritance tax return that is originally filed on or after the effective date of this 2005 Act may be amended to make the elections described in sections 2 and 3 of this 2005 Act as otherwise prescribed by law.

(3)(a) If a refund is made as the result of the filing of an amended return that is allowable because of the date for filing amended returns under subsection (1)(a) of this section, the refund may not bear interest, unless the refund is made on or after March 1, 2007.

(b) A refund described in paragraph (a) of this subsection that is made on or after March 1, 2007, and attributable to the elections described in sections 2 and 3 of this 2005 Act shall bear interest as prescribed in ORS 305.220, for the period beginning March 1, 2007, and ending on the date the refund is made.

(4) Once made, an election described in sections 2 and 3 of this 2005 Act is irrevocable.

240 H.R.B. 2469, 73d Legis. Assemb., Reg. Sess., § 2(2) (Or. 2005) (enacted June 6, 2005).

241 *Id*. § 2(2)(a).

242 *Id*. § 2(2)(b).

243 *Id*. § 2(2)(c).

244 *Id*. §§ 2(1), 4.

245 Karey Schoenfeld & Jeffery M. Cheyne, Oregon State Bar Legislative Proposal, *Oregon Inheritance Tax Legislation*, at 1, *available at* http://www.osbar.org/_docs/ legprop/taxation_inheritance.pdf (last visited Apr. 11, 2005).

tate-planning practitioners regarding existing credit shelter trusts that have been negatively impacted by the recent changes in the state and federal death tax systems and meeting the public policy goal of keeping Oregon's inheritance tax connected to federal laws "to the extent possible."[246]

HB 2469 will help solve three existing planning problems created by the enactment of EGTRRA along with Oregon's subsequent decoupling from federal law. The first two problems exist because trusts providing for discretionary distributions and trusts with multiple current beneficiaries do not presently qualify for the Oregon QTIP election.[247] The third problem involves the increased risk of malpractice for estate-planning practitioners.

Because many existing credit shelter trusts were drafted with provisions for discretionary distributions for beneficiaries other than the surviving spouse, they do not meet the current requirements for an Oregon QTIP election. HB 2469 allows discretionary trusts to qualify for tax deferral until the surviving spouse dies.[248] HB 2469 also allows existing multiple-beneficiary trusts to get the same tax treatment if the nonspouse beneficiaries consent to irrevocably disclaiming their trust interests until after the death of the surviving spouse.[249] These changes alleviate the need to amend many existing trusts and wills and will therefore be a great benefit to Oregonians.[250] HB 2469 also will lessen the potential malpractice risk for Oregon's estate-planning practitioners arising out of existing estate plans that were drafted prior to EGTRRA and which are no longer optimized to minimize the effects of taxation.[251] The time and costs saved from fewer malpractice suits will benefit taxpayers, their beneficiaries, and practitioners. Because HB 2469's proposed changes will allow for tax deferral until the surviving spouse dies, it will help alleviate all

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[246] *See id.*

[247] *See id.* at 1-2.

[248] *See* H.R.B. 2469 §§ 2(1)-(2)(a), 4.

[249] *See id.* §§ 2(1), 3(2)-(3), 4.

[250] Schoenfeld & Cheyne, *supra* note 245, at 2.

[251] *See id.* One concern of long-time Oregon practitioners is that former clients whose existing estate plans were originally created so that no state taxes would be due at the death of the first spouse might now owe taxes under post-EGTRRA law. Telephone Interview with Charles J. McMurchie, of Counsel, Stoel Rives LLP (Feb. 17, 2005). Attempting to contact former clients whose estate plans were created some time ago and who have not since worked with the original drafting attorney to discuss such problems might also potentially be considered improper solicitation of business. *Id.*

three problems discussed above and should provide additional flexibility when creating a trust funded with the difference between the Oregon and federal exemption amounts.

Although its provisions are too broad to qualify for federal QTIP treatment,[252] the clever thing about HB 2469 is that this will likely not matter. The amount of property intended to be considered for the Oregon Special Marital Property election will fall within the gap between the Oregon and federal exemption amounts, so this property will already be exempt from federal taxation. Only property exceeding the federal exemption amount will be subject to taxation; thus, this excess property will be the only property that needs to either qualify for federal QTIP treatment or pass via the marital deduction in order to receive tax deferral. A separate trust for this property can be created to take advantage of the federal QTIP rules.

The revenue implications of HB 2469 are somewhat unknown. The authors of the bill discuss its changes as being "relatively income-neutral" and recognize that there may be a possible loss of tax revenue with the bill's enactment due to the possibility that surviving spouses may move out of Oregon prior to their deaths.[253] One author reasons that, currently, taxpayers "can merely change their wills and trusts and achieve the same result" as HB 2469's provisions allow.[254] While this is true from a theoretical standpoint, this argument may overlook the indirect revenue losses from both a temporal standpoint and from EGTRRA's increased incentives for taxpayers to change their domiciles to reduce the effect of death taxes.

Under HB 2469, more taxpayers may elect to defer their taxes until the death of their surviving spouses than would otherwise have changed their nonconforming wills and trusts to allow for such deferral via an Oregon QTIP election. If so, current inheritance tax revenue may be lower under HB 2469 than it would have been if taxpayers were actually required to change their estate plans to allow for an Oregon QTIP. While this tax money may still find its way to Oregon's coffers upon the death of the second spouse, HB 2469 does nothing for Oregon's current fiscal

[252] Expanding the definition of qualifying property beyond that of the current Oregon QTIP will necessarily disqualify it from meeting federal QTIP requirements.

[253] Schoenfeld & Cheyne, *supra* note 245, at 2.

[254] E-mail from Karey Schoenfeld, Chair, Oregon State Bar Tax Section, to Steven D. Nofziger, student, University of Oregon School of Law (Feb. 9, 2005, 8:22 AM PST) (on file with author).

needs. In addition to future taxes having lower present values,[255] the time lag might well result in such tax revenue never being received or being less than it otherwise would have been under pre-HB 2469 Oregon law because of reductions in the value of such trusts' assets or future increases in Oregon's exemption that occur prior to the death of the second spouse.

Given the incentives created by EGTRRA for taxpayers to change their domiciles as a means of avoiding death taxes, a future trend may develop where residents leave Oregon and other decoupled states for states without death taxes.[256] Because taxpayers who do not change their existing nonconforming estate plans can still elect to defer inheritance taxes under HB 2469, there will be a longer period of time during which Oregon assets could be removed from the state's taxing jurisdiction. Thus, HB 2469 again indirectly creates the possibility of a negative impact on Oregon's future budgets. Admittedly, any negative fiscal impact of these scenarios is somewhat remote, difficult to ascertain, and actually grows out of the effects of EGTRRA rather than any direct effects of HB 2469.

Overall, HB 2469 should benefit Oregonians. It will save Oregon taxpayers the time and expense of redrafting their existing wills and trusts to conform to Oregon's QTIP requirements. HB 2469 will also reduce the potential for attorney malpractice suits growing out of existing nonconforming estate plans that were drafted prior to EGTRRA and that are no longer optimized to minimize taxation. These benefits will likely offset any detrimental effects caused by the possible loss of tax revenue, which would have been likely to occur under EGTRRA anyhow. Because of its minimal negative fiscal effects and its large potential benefits, the Oregon legislature was wise to enact HB 2469 rather than a bill that would have completely reconnected Oregon to federal law and triggered a large loss of state tax revenue.

Conclusion

The enactment of EGTRRA created many direct and indirect effects on the State of Oregon, its taxpayers, and its estate-planning practitioners. EGTRRA was a boulder dropped in the waters of what was once a reasonably calm pond of tax law related

255 The present value of a dollar received in the future is worth less than a dollar received today.

256 This statement assumes that there are states without an inheritance tax.

to the transfer of a decedent's property. EGTRRA has created a wave of uncertainty for states, taxpayers, and estate planners. The repeal of the state death tax credit as of January 2005 is only the most recent ripple in the pond. Many states, including Oregon, are still attempting to figure out how best to deal with the impact. The possibility of the permanent repeal of the federal estate tax in 2010 and the scheduled sunset of EGTRRA in 2011 means that it is difficult for taxpayers to make long-term estate plans.

For Oregonians, this difficulty is compounded because Oregon's inheritance tax is decoupled from the federal system, creating the current disjunction from the federal exemption and an extra layer of taxation. It is likely that many more effects will be felt as Oregon continues to grapple with how best to handle its fiscal needs as well as its residents' need for stability in the tax code so that they can plan how to bequeath their estates. There is no "right answer" in the current estate-planning environment, but approaches that provide for extra flexibility, such as the use of disclaimers or QTIP elections upon the death of the decedent, may well become more useful in the coming years. Understanding the new basis rules will also become critical.

Many of the recent legislative proposals will likely reappear for consideration before Oregon's legislature in future years. HB 2469's enactment and creation of the Oregon Special Marital Property election is a nice step forward in alleviating some of the current estate-planning problems without causing major fiscal effects. HB 2469 is a reasonable solution to the problems caused by the disjunction between Oregon and federal law. Future proposals similar to HB 2629 and HB 3421 would also pose interesting implications. Because such proposals would further simplify estate planning by matching Oregon's inheritance tax exemptions to federal law, would possibly be revenue neutral, and would likely benefit many Oregonians at the expense of a few, they should also be seriously considered by the legislature in the future as a means of simplifying Oregon's inheritance tax system without the potential drastic revenue implications that other recent proposals would create.

Future proposals similar to the other bills discussed in Part VII would likely benefit only a few Oregonians at the expense of the vast majority due to the likely negative fiscal impacts on Oregon's budget. Because of their negative revenue implications, it

would be unwise for the legislature to implement any such proposals in the future unless replacement revenue sources are found.

In the final analysis, there is still much uncertainty surrounding the current death taxes at both the federal and state levels. Perhaps the best suggestion for Oregon taxpayers and estate planners during the next few years is to be flexible and to review their estate plans often. Will Rogers' sage statement seems all too appropriate to the current estate-planning environment: "The difference between death and taxes is death doesn't get worse every time Congress meets."[257]

[257] *E.g.*, The Virginia Land Rights Coalition, Quotes, *at* http://www.vlrc.org/quotes. html (last visited June 29, 2005).